Assigned = Jacobs

DRB

UNITED STATES TAX COURT

WASHINGTON, DC 20217

ARTHUR I. APPLETON, JR., Petitioner	)	
THE GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS, Intervenor	)	Docket No. 7717-10.
v.	)	
COMMISSIONER OF INTERNAL REVENUE, Respondent	)	

ORDER AND DECISION

On November 8, 2011, petitioner filed a Motion for Summary Judgment. On May 22, 2013, the Court rendered an Opinion (140 T.C. No. 14), with respect to petitioner's motion, holding in favor of petitioner. Petitioner thereafter filed a Motion for Litigation Costs on June 25, 2013. On July 26, 2013, respondent filed a reply to petitioner's motion. On September 27, 2013, petitioner filed a response to respondent's reply, and on October 17, 2013, petitioner filed an amended response to respondent's reply. On January 24, 2014, the undersigned held a conference call with respective counsel for petitioner and respondent pursuant to which an issue was raised that had not been discussed by the parties in their papers. As a result of that discussion, on January 28, 2014, petitioner filed a First Supplement to Motion for Litigation Costs.

Section 7430[1] provides for the award of reasonable costs for any administrative (not relevant here) or Court proceedings against the United States brought in connection with the determination, collection, or refund of any tax, interest, or penalty pursuant to the Internal Revenue Code. Sec. 7430(a). An award of litigation costs may be made where (1) the taxpayer is the "prevailing party"; (2) the taxpayer did not unreasonably protract the proceedings; (3) the amount of costs requested is reasonable; and (4) all administrative remedies available to the taxpayer have been exhausted. Sec. 7430(a), (b)(1), (3), (c); Vines v. Commissioner, T.C. Memo. 2006-258. These requirements are conjunctive, and the failure to satisfy any one of them will preclude an award of costs. See Minahan v. Commissioner, 88 T.C. 492, 497 (1987). Petitioner has the burden of establishing that he satisfied each requirement of section 7430. Rule 232(e); see also Grant v. Commissioner, 103 F.3d 948, 952 (11th Cir. 1996), aff'g T.C. Memo 1995-374.

To be a prevailing party, a taxpayer must (1) substantially prevail with respect to the amount in controversy or the most significant issue or set of issues presented, sec. 7430(c)(4)(A); and (2) meet the timing and net worth requirements of the first sentence of 28 U.S.C. sec. 2412(d)(1)(B), incorporated by reference in section 7430(c)(4)(A)(ii). But even if a taxpayer substantially prevails for purposes of section 7430, the taxpayer will not be treated as the prevailing party if respondent establishes that his position was substantially justified. Sec. 7430(c)(4)(B)(i); Rule 232(e).

A position is substantially justified if it is "'justified in substance or in the main'–that is justified to a degree that could satisfy a reasonable person" or has "a reasonable basis both in law and fact." Pierce v. Underwood, 487 U.S. 552, 565 (1988); Nicholson v. Commissioner, 60 F.3d 1020, 1025-1026 (3d Cir. 1995), rev'g T.C. Memo. 1994-280. Respondent's position may be justified even if it is ultimately rejected by the Court. Estate of Wall v. Commissioner, 102 T.C. 391, 393 (1994) (quoting Wilfong v. United States, 991 F.2d 359, 364 (7th Cir. 1993)).

The issue involved in this case was one of first impression. And generally, when an issue is one of first impression, respondent's position is considered to be

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[1]Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended (Code), and all Rule references are to the Tax Court Rules of Practice and Procedure.

substantially justified if (1) respondent's position is not contrary to any published decision, and (2) a "reasonable person [could not] say that it lacked colorable justification." Estate of Wall v. Commissioner, 102 T.C. at 394. However respondent's position in a case involving an issue of first impression will not be considered substantially justified when that position conflicts with the "clear and unequivocal" language of the statute. Nalle v. Commissioner, 55 F.3d 189, 193 (5th Cir. 1995), aff'g T.C. Memo. 1994-182. If respondent's interpretation of a statute lacks "any ligaments of fact" and is clearly erroneous as a matter of law, Portillo v. Commissioner, 988 F.2d 27, 29 (5th Cir. 1993) (quoting Portillo v. Commissioner, 932 F.2d 1128, 1133 (5th Cir. 1991)), rev'g T.C. Memo. 1992-99, or if none of the arguments offered by the Internal Revenue Service (IRS) during the various states of litigation has a chance of succeeding, Beaty v. United States, 937 F.2d 288, 292-293 (6th Cir. 1991), respondent's interpretation is considered to violate the clear and unequivocal language of the statute and hence is not substantially justified. Newman v. Commissioner, T.C. Memo. 2012-74.

For the reasons set forth hereafter, we find that respondent has established that his position was substantially justified.

U.S. Virgin Islands' residents occupy an anomalous position under U.S. tax law. Because petitioner was both a U.S. citizen and a bona fide resident of the U.S. Virgin Islands during each of the years in question, we were required to consider the interaction between the United States and U.S. Virgin Islands tax laws. Specifically, we had to decide whether the filing of an income tax return by a U.S. Virgin Islands resident with the U.S. Virgin Islands Bureau of Internal Revenue (VIBIR) commenced the running of the period of limitations on assessment and collection of tax for U.S. income tax purposes.

As a bona fide resident of the U.S. Virgin Islands, and having U.S. Virgin Islands sourced income, petitioner was required to file an income tax return with the VIBIR. Sec. 932(c)(2). And as a U.S. citizen, petitioner was required to file a Federal income tax return with the IRS reporting his worldwide income.[2] No

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[2]Section 6012 mandates that individuals having gross income equal to or exceeding a specified exempt amount set forth in section 6012(a)(1)(A) must file a tax return with the IRS. Section 932(c)(4) notionally reduces a bona fide resident of the U.S. Virgin Islands' gross income for Federal income tax purposes below

(continued...)

single statute governs the Federal filing requirement of a U.S. Virgin Islands resident who fails to meet the requirements of section 932(c)(4). Rather, an interplay among various sections of the Code (i.e., sections 6012, 6091, 6501 and 7654(e)), as well as the regulations promulgated thereunder and forms and instructions published by the IRS, determines the filing requirements.

Respondent determined that petitioner's filing an income tax return with the VIBIR does not automatically commence the running of the period of limitations for Federal tax purposes. Respondent did not create this position out of whole cloth. The statutes, legislative history, and prior jurisprudence make clear that the United States and the U.S. Virgin Islands are separate taxing jurisdictions, each with its own reporting and tax payment requirements. See Danbury, Inc. v. Olive, 820 F.2d 618, 620-621 (3d Cir. 1987); Chi. Bridge & Iron Co. v. Wheatley, 430 F.2d 973, 976 (3d Cir. 1970); Dudley v. Commissioner, 258 F.2d 182, 185 (3d Cir. 1958), aff'g 28 T.C. 992 (1957); Huff v. Commissioner, 138 T.C. 258, 265-266 (2012); Huff v. Commissioner, 135 T.C. 222, 224 (2010). However, because of the complex interaction between the relevant Code sections and the applicable regulations, forms, and instructions, we found respondent did not properly recognize that the Code and the regulations directed petitioner to file his income

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[2](...continued)
the filing threshold if the resident satisfies all of that section's requirements. This has the effect of eliminating the resident's Federal tax filing requirement. But if the requirements of section 932(c)(4) are not met, two tax returns are potentially due from U.S. taxpayers with U.S. Virgin Islands connections. Petitioner claimed he qualified for the gross income tax exclusion provided by section 932(c)(4) for each of the years in question. Therefore, he maintains he did not have to file a Federal income tax return or pay income tax to the IRS.

The legislative history of section 932 states that Congress intended "to make it clear that individuals who do not comply with all requirements for U.S. tax exemption will have to file a U.S. return." S. Rept. No. 100-445, at 315 (1988), 1988 U.S.C.C.A.N. 4515, 4826-4827. Prior to 1988, section 932(c)(2) provided that a taxpayer "shall file his income tax return for the taxable year with the Virgin Islands." This language was changed by the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, sec. 1012(w)(3), 102 Stat. at 3530, to "file an income tax return" to emphasize the residual U.S. filing requirements and tax liabilities.

tax return with the VIBIR to fulfill his Federal income tax return filing obligations.

We do not believe that a reasonable person would conclude that respondent's position in this matter violated the "clear and unequivocal" language of the statutes, or was clearly erroneous as a matter of law, or lacked colorable justification.

Section 7430(c)(4)(B)(ii) provides that respondent's position is not presumed to be substantially justified if respondent did not follow applicable published guidance. Section 7430(c)(4)(B)(iv) defines "published guidance" as (1) regulations, revenue rulings, revenue procedures, information releases, notices, and announcements, and (2) any of the following which are issued to the taxpayer: private letter rulings, technical advice memoranda, and determination letters. Petitioner asserts his position is substantially similar to the position taken in Field Service Advice 199906031, issued on February 12, 1999. That field service advice held that a tax return filed by a bona fide resident of the U.S. Virgin Islands with the VIBIR commenced the period of limitations for Federal income tax purposes under section 6501 even though dividend income from U.S. sources was not reported on the tax return, as required by section 932(c)(4). Hence, petitioner maintains respondent's position in this case is contrary to published guidance.

Petitioner's position is without merit. A field service advice is not one of the documents set forth in section 7430(c)(4)(B)(iv), i.e., it is not a document published for public use or issued to a particular taxpayer, rather it is an internal, nonprecedential document provided to employees for their guidance. See sec. 6110(k)(3). In any event, in Chief Counsel Advice 200624002, issued June 16, 2006, respondent's Office of Chief Counsel changed the position set forth in Field Service Advice 199906031.

Because respondent's position in this matter was colorable, we find it was also substantially justified. See Newman v. Commissioner, T.C. Memo. 2012-74. Because respondent's position was substantially justified, petitioner is not the prevailing party for purposes of section 7430(c)(4). Consequently, petitioner is not entitled to an award of litigation costs under section 7430.

The premises considered, it is

ORDERED that petitioner's Motion for Litigation Costs as Supplemented is DENIED. It is further

ORDERED that Petitioner's Motion for Summary Judgment is GRANTED. It is further

ORDERED AND DECIDED that there are no deficiencies in petitioner's Federal income tax or additions to tax for years 2002, 2003, and 2004.

(Signed) Julian I. Jacobs
Judge

ENTERED: JAN 31 2014