Sub- Holmes

UNITED STATES TAX COURT

WASHINGTON, DC 20217

PA

KEVIN A. SELLS, et al.,	)	
	)	
Petitioners,	)	
	)	
v.	)	Docket Nos. 6267-12, 6801-12,
	)	6835-12, 6836-12,
COMMISSIONER OF INTERNAL REVENUE,	)	6837-12, 6838-12,
	)	19246-12, 13553-13.
Respondent.	)	
	)	
	)	
	)	
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ORDER

These consolidated cases were tried in October 2016 at a special trial session in Birmingham, Alabama. One of the issues was whether petitioners owed 40% gross-valuation-misstatement penalties under I.R.C. § 6662(h)(1) for allegedly overstating the value of their conservation easement by 400% or more. Both parties introduced a great deal of evidence on the value of the donated conservation easement and petitioners' return preparation.

But no one tried to introduce evidence about whether the Commissioner met his burden of production under I.R.C. § 6751(b)(1) to show that "the initial determination of such assessment [i.e., of the penalties] [wa]s personally approved (in writing) by the immediate supervisor of the individual making such determination." We hold today in *Graev v. Commissioner*, 149 T.C. ___, ___ (Dec. 20, 2017) (*Graev III*) (slip op. at 13-15), that the Commissioner must show compliance with this section in any deficiency case where penalties are at issue.

The Commissioner saw this coming. On June 20, 2017, he moved to reopen the record to add evidence that he argues shows that he complied with I.R.C. § 6751(b)(1). Petitioners object.

In our concurring opinion in *Graev III*, this division of the Court warned that "'[l]ike some ghoul in a late-night horror movie that repeatedly sits up in its grave and shuffles abroad,' [this construction of I.R.C. § 6751] will serve only to frighten little children and IRS lawyers." *Graev III*, 149 T.C. at __ (slip op. at 45) (Holmes, J., concurring) (quoting *Lamb's Chapel v. Ctr. Moriches Union Free Sch. Dist.*, 508 U.S. 384, 398 (1993) (Scalia, J., concurring)).

This third of four motions that we dispatch today forces us to face yet another of these *Chai* ghouls -- this one with only a slight twist from another that we rule on today -- that is also presumptively appealable to the Eleventh Circuit.

Background

The petitions in these cases were filed between March 2012 and June 2013. Before the original trial date in May 2014, we consolidated them because they involve the same non-TEFRA partnership. The parties then asked for a continuance, which we granted so that the parties could continue their settlement talks. But settlement talks apparently broke down. And after the case was reassigned to this division of the Court, we set the case for a special trial session to begin in October 2016.

With the case now going to trial, important filings started coming in. The Commissioner filed motions for leave to amend his answers in August 2016 -- less than two months before trial. He wanted to amend his answers to raise 40% gross-valuation-misstatement penalties, because he had only determined 20% accuracy-related penalties in the notices of deficiency. He didn't allege in either the motions or the amended answers themselves that he had complied with I.R.C. § 6751(b)(1). Petitioners objected to these motions: They argued that the Commissioner was dilatory; that granting the motions would prejudice them; and that the Commissioner "conveniently overlook[ed] its . . . obligations . . . under I.R.C. § 6751(b)." "In light of the timing of th[e] penalty assertion," petitioners argued, "it [was] very unlikely that the [Commissioner] followed proper procedures in raising this new penalty."

A couple weeks before trial we granted the Commissioner's motion for leave to amend because he had good cause for his delay (expert valuation reports had only recently come in), and it wouldn't prejudice petitioners (there is no

special defense to the gross-valuation-misstatement penalty). We also notified the parties that we were aware the I.R.C. § 6751(b) issue had been raised and extensively briefed in *Graev II*, so we invited "the parties to develop any relevant facts at trial and address the issue in posttrail briefs."

The parties lodged a first joint stipulation of facts and exhibits with the Court almost two months before trial. They did not stipulate to the Commissioner's compliance with I.R.C. § 6751(b)(1), and the stipulation included no evidence of supervisory approval for the initial determination of the gross-valuation-misstatement penalties. The parties also filed a supplemental stipulation of facts at trial. Once again, they did not stipulate to the Commissioner's compliance with I.R.C. § 6751(b)(1), and the stipulation included no evidence of supervisory approval for the initial determination of the gross-valuation-misstatement penalties.

We held the trial between October 3 and October 5. The Commissioner didn't present any evidence at trial that he had complied with I.R.C. § 6751(b)(1).

We issued *Graev v. Commissioner*, 147 T.C. ___ (Nov. 30, 2016) (*Graev II*), less than two months later. In *Graev II* we held that compliance with I.R.C. § 6751(b)(1) is not ripe for review in a deficiency case because the penalty has not yet been "assessed". *Id.* at ___ (slip op. at 24-39).

The Commissioner then filed his posttrial opening brief less than two months after that.[1] He argued that I.R.C. § 6751(b) doesn't apply to deficiency cases before our Court. In a bit of foreshadowing, he then argued in the alternative that he had met the requirements of I.R.C. § 6751(b) because the IRS Chief Counsel lawyer's "initial determination to seek a gross valuation misstatement penalty" was approved by his immediate supervisor. Indeed, the Commissioner said then -- as he does now -- that the IRS Chief Counsel lawyer "made th[e] determination by drafting each motion to amend the answer and each amendment to answer," and the IRS Chief Counsel supervisor "approved these determinations in writing by initialing (agb) on the drafts."

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[1] We decided on the last day of trial that the burden shifted to the Commissioner under I.R.C. § 7491(a), so he was required to file the opening brief.

A couple more months passed before the Second Circuit issued its decision in *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 2017), *aff'g in part, rev'g in part* 109 T.C.M. 1206. In it, the Second Circuit held that we were wrong in *Graev II* and that the Commissioner had to show that he complied with I.R.C. § 6751(b)(1) as part of his burdens of production and proof on penalties in deficiency cases. *See Chai*, 851 F.3d at 218-23. Today we adopt the Second Circuit's holding in *Chai* as our own. *See Graev III*, 149 T.C. at ___ (slip op. at 13-15).

Petitioners filed their answering brief about two months after *Chai*. They devoted several pages to the requirements of I.R.C. § 6751(b), and argued that the Commissioner "is precluded from imposing the gross-valuation misstatement penalty under section 6662(h) because [he] has failed to meet [his] burden of demonstrating compliance with section 6751(b)." Citing to the "Entire Record," they pointed out that the Commissioner "presented no evidence at trial that a manager approved, in writing, an initial determination to assert the gross-valuation misstatement penalty." "Accordingly," they argued, "the gross-valuation misstatement [penalty] cannot be imposed."

A little over one month later the Commissioner moved to reopen the record so that he could admit evidence that shows he met the requirements of I.R.C. § 6751(b)(1) for the gross-valuation-misstatement penalties. We consider that motion here. But before we do, we note that the Commissioner told us earlier this year in his opening brief that evidence of I.R.C. § 6751(b)(1) compliance is already in the record. More specifically, he said that the IRS Chief Counsel lawyer "made th[e] [initial penalty] determination by drafting each motion to amend the answer and each amendment to answer," and the IRS Chief Counsel supervisor "approved these determinations in writing by initialing (agb) on the drafts." The amendments to answers -- complete with typed initials -- are already in the record.

So what exactly does the motion here seek to admit? Presumably because the typed initials on the amendments to answers are at best ambiguous without some explanation, the Commissioner now wants to add the IRS Chief Counsel lawyer's and the IRS Chief Counsel supervisor's declarations to the record. The declarations explain that the IRS Chief Counsel supervisor is the immediate supervisor of the IRS Chief Counsel lawyer who is assigned to this case; that the IRS Chief Counsel lawyer determined that gross-valuation-misstatement penalties

were warranted in this case; that the IRS Chief Counsel supervisor agreed with the IRS Chief Counsel lawyer's determination to move to amend the pleadings in order to assert the gross-valuation-misstatement penalties; and that he approved that determination in writing by typing his initials on the motions for leave to file amendments to answers and the amendments to answers. The initialed amendments to answers are attached to the supervisor's declaration.

Should we reopen the record now to let the declarations in? Petitioners say we shouldn't. Their first argument is that we shouldn't reopen the record because the Commissioner's failure to have the IRS Chief Counsel supervisor and lawyer testify at trial shows a lack of diligence, and petitioners would be prejudiced if the declarations were admitted into evidence now when they don't have the opportunity to cross-examine either one. Their second argument is that we shouldn't reopen the record to admit the declarations because they're inadmissible hearsay.

Analysis

The decision to reopen the record to admit additional evidence is within our discretion. *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U.S. 321, 331 (1971). Indeed, a trial "judge has broad discretion to reopen a case to accept additional evidence, and his decision will not be overturned absent an abuse of that discretion." *Hibiscus Assocs. Ltd. v. Bd. of Trs. of the Policemen & Firemen Ret. Sys. of the City of Detroit*, 50 F.3d 908, 917-18 (11th Cir. 1995) (citing *Zenith Radio Corp.*, 401 U.S. at 331).

Our discretion is not unbounded. As a threshold matter, we will not reopen the record "unless the evidence to be presented was not available for use at the original trial or could not have been obtained with reasonable diligence." *Snuggery-Elvis P'ship v. Commissioner*, 64 T.C.M. 1128, 1132 (1992) (citing *Zenith Radio Corp.*, 401 U.S. at 332-33; *Purex Corp. v. Procter & Gamble Co.*, 664 F.2d 1105, 1109 (9th Cir. 1981); *Mayer v. Higgins*, 208 F.2d 781, 783 (2d Cir. 1953); *Glagola v. Commissioner*, 59 T.C.M. 321 (1990)); *see also Cloes v. Commissioner*, 79 T.C. 933, 937 (1982) ("Proper judicial administration demands that there be an end to litigation and that bifurcated trials be avoided"); *Markwardt v. Commissioner*, 64 T.C. 989, 998 (1975) (It is our Court's "policy . . . to try all issues raised in a case in one proceeding and to avoid piecemeal and protracted

litigation"). And we'll weigh the Commissioner's diligence (or lack thereof) against any possible prejudice to petitioners if we were to grant the motion to reopen the record. *See Garcia v. Woman's Hosp. of Tex.*, 97 F.3d 810, 814 (5th Cir. 1996) (trial court should consider "importance and probative value of the evidence, the reason for the moving party's failure to introduce the evidence earlier, and the possibility of prejudice to the non-moving party").[2] "Prejudice" in this context focuses on whether the submission after trial prevents the nonmoving party from examining and questioning the evidence as it would have during the proceeding. *Estate of Freedman v. Commissioner*, 93 T.C.M. 1007, 1013 (2007); *Megibow v. Commissioner*, 87 T.C.M. 987, 991 (2004).

Even if the Commissioner crosses that threshold, we still won't let him past the foyer unless the evidence he seeks to add to the record is not merely cumulative or impeaching, is material to the issues involved, and probably would change the outcome of the case. *Butler v. Commissioner*, 114 T.C. 276, 287 (2000), *abrogated on other grounds by Porter v. Commissioner*, 132 T.C. 203 (2009). This second test is consistent with the Fifth Circuit framework: The trial court should consider "*the importance and probative value of the evidence*, the reason for the moving party's failure to introduce the evidence earlier, and the possibility of prejudice to the non-moving party." *Garcia*, 97 F.3d at 814 (emphasis added). Indeed, it would be futile to reopen the record -- and bifurcate the trial -- only to let in evidence that has no impact on the outcome of the case.

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[2] This Fifth Circuit case was decided after September 30, 1981, *see Bonner v. City of Prichard*, 661 F.2d 1206, 1209 (11th Cir. 1981) (en banc), but our research turned up few cases in the Eleventh Circuit that involved a prejudgment motion to reopen the record. And those cases only determine whether there was an abuse of discretion; they don't provide an analytical framework. *See, e.g.*, *Hibiscus Assocs. Ltd. v. Bd. of Trs. of the Policemen & Firemen Ret. Sys. of the City of Detroit*, 50 F.3d 908, 917-18 (11th Cir. 1995); *Lundgren v. McDaniel*, 814 F.2d 600, 607 (11th Cir. 1987). In *United States v. Byrd*, 403 F.3d 1278 (11th Cir. 2005), however, the Eleventh Circuit found it helpful to look to Fifth Circuit precedent about reopening the record. *See id.* at 1283 n.1 (resorting in criminal case to specific Fifth Circuit test to determine if trial court abused its discretion when it didn't reopen the record for criminal defendant to testify). We will do likewise.

We'll consider diligence and prejudice first. The timeline here makes the question of the Commissioner's diligence a little muddled. I.R.C. § 6751 made its debut in the Code almost twenty years ago, but we didn't take much notice of it in deficiency cases until 2015. *See Chai v. Commissioner*, 109 T.C.M. 1206 (2015); *Legg v. Commissioner*, 145 T.C. 344 (2015).[3] In *Chai*, we avoided the issue because the taxpayer didn't raise it until his posttrial brief. *See Chai*, 109 T.C.M. at 1212. And in *Legg* we found that the Commissioner had complied with I.R.C. § 6751(b)(1), even if we didn't say whether it was necessary for him to do so before a case came to our Court. *See Legg*, 145 T.C. at 349-51.

The Commissioner says in his motion that "[a]t the time [he] presented his case at trial and filed his opening brief, there was no obligation to show compliance with I.R.C. § 6751(b)(1) in a deficiency case." The Commissioner appears to be referring to our opinion in *Graev II*, which we admit did complicate things a bit. But *Graev II* wasn't released until more than a month after the trial here. That weakens the Commissioner's excuse, especially when we encouraged him to develop any relevant facts at trial regarding his compliance with I.R.C. § 6751(b)(1) and the text of that section has been the same for nearly twenty years.

And the Commissioner has an even bigger problem: Our decision in *Graev III* didn't create new law; it interpreted a section of the Code that was in effect at the time of the trial in this case, and which we today announce we apply to the parties before us in *Graev III*. *See Harper v. Va. Dept. of Taxation*, 509 U.S. 86, 97 (1993) (when the Court applies a rule of federal law to the parties in a case, that rule "must be given full retroactive effect in all cases still open on direct review and as to all events, regardless of whether such events predate or postdate the announcement of the rule"). The Eleventh Circuit follows *Harper* as a general rule, though it has clarified that civil-law changes might still be applied on a prospective-only basis in certain circumstances. *See Glazner v. Glazner*, 347 F.3d 1212, 1217-20 (11th Cir. 2003). The Eleventh Circuit applies a newly announced rule of law to the case before it and to all cases that are still open, unless it holds in the case announcing the rule that it lacks retroactive effect. *See id.* at 1217-18. Such a holding requires an analysis under the test that the Supreme Court made up

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[3] Note also *Lindberg v. Commissioner*, 99 T.C.M. 1273, 1279 (2010), where § 6751 briefly premiered only to be dismissed as inapplicable to a penalty under § 6702.

in *Chevron Oil Co. v. Huson*, 404 U.S. 97, 105-09 (1971): (1) the decision establishes a new principle of law; (2) retrospective operation would retard the rule's operation; and (3) retroactive application of the rule would be inequitable. *Glazner*, 347 F.3d at 1217-20. Even if the Supreme Court were to revive *Chevron Oil*, and even if the Tax Court adopted the Eleventh Circuit's refinements to it, nowhere in *Graev III* did we state (much less analyze whether) it should apply only prospectively. So, consistent with *Harper* and *Glazner*, we have to treat our construction of I.R.C. § 6751(b)(1) in *Graev III* as being the correct construction of the section as of the date of the trial in these cases.

The Commissioner has even less reason to complain about any unfairness here than in most cases that are still pending: Petitioners raised § 6751(b)(1) before trial in their response to the Commissioner's motion for leave to amend his answers, we told the Commissioner to develop any relevant I.R.C. § 6751(b)(1) facts at trial, and the Commissioner presented evidence that he had complied with I.R.C. § 6751(b)(1) in at least one other case -- another conservation-easement case -- that had already been decided, *see Legg*, 145 T.C. at 347. The Commissioner argues -- and may yet prove persuasive -- that the supervisor's written approval is already in the record in the form of his typed initials on the motions for leave to amend and the amended answers. But petitioners may likewise point to the same initials on other filings in the record and argue that these initials are quite meaningless without some explanation from the Commissioner. We observe only that, in this motion to reopen the record, the Commissioner does not argue that it would have been difficult for him to get the IRS Chief Counsel supervisor or lawyer to testify, which also makes his failure look like a lack of diligence.

The testimony was of reasonably foreseeable importance: Even if I.R.C. § 6751(b) hadn't yet been analyzed by any Court, its existence at the time of trial is undisputed and petitioners made it clear that they intended to raise it as one of their attacks on penalties. If the Commissioner had called the IRS Chief Counsel supervisor and lawyer to testify at trial petitioners could have cross-examined them. But the trial is over and the record closed -- "[o]ur judicial system does not contemplate that the rights of litigants shall be held in abeyance for months or years in order that hindsight may provide a more accurate appraisal of evidence." *NLRB v. Jacob E. Decker & Sons*, 569 F.2d 357, 365 (5th Cir. 1978) (quoting *Locklin v. Switzer Bros., Inc.*, 299 F.2d 160, 169 (9th Cir. 1961)). That is why a

trial court properly denies a motion to reopen the record "where the litigant was negligent in failing to introduce the evidence," particularly when granting the motion would prejudice the nonmoving party. *See Garcia*, 97 F.3d at 814.

And we do agree with petitioners that they would be prejudiced if we admitted the declarations -- they would lose a chance to examine and question the evidence as they would have at trial. *Estate of Freedman*, 93 T.C.M. at 1013; *Megibow*, 87 T.C.M. at 991. On this point, petitioners correctly state that they can't cross-examine a piece of paper, and they tell us some of the questions they would've asked: (1) did the first IRS Chief Counsel lawyer -- who was apparently assigned to the case before the current one -- ever make a penalty determination?; (2) is there a more "immediate" supervisor between IRS Chief Counsel lawyer and IRS Chief Counsel supervisor?; and (3) were the penalties ever previously determined but not approved?

We won't guess at how petitioners' cross-examination might have gone. But we do agree that there is prejudice in the loss of a chance to cross-examine the IRS Chief Counsel supervisor and lawyer. *See Megibow*, 87 T.C.M. at 991 (explaining that the nonmoving party is prejudiced when the moving party submits evidence after trial, because the nonmoving party is "deprived . . . of any opportunity to examine or question them during the proceeding").

There is another problem here: Recall that our discretion to reopen the record is limited by the additional requirement that the moving party must show that the additional evidence probably would change the outcome of the case. *Butler*, 114 T.C. at 287. On this part, the Commissioner has a serious problem, because the proffered declarations are inadmissible hearsay. *See* Fed R. Evid. 801(c), 802; *see also, e.g.*, *Paradiso v. Commissioner*, 90 T.C.M. 110, 113 (2005) (citing, among other cases, *Woodall v. Commissioner*, 84 T.C.M. 700, 703 n.6 (2002)).

The Commissioner might argue that the declarations are admissible under the business-records exception to hearsay, *see* Fed. R. Evid. 803(6), but we can't agree: They were prepared almost a year after the amended answers and don't appear to be documents that are kept in the course of a regularly conducted activity of the IRS. And they *are* offered here for the truth of the matters asserted in them -- that the IRS Chief Counsel supervisor approved the IRS Chief Counsel

lawyer's "initial determination" of penalties and that his typed initials on the amended answers were intended as that written supervisory approval. Even if we found that the Commissioner was diligent and petitioners wouldn't be unfairly prejudiced, we still wouldn't reopen the record to admit the declarations because they're inadmissible hearsay.

It is therefore

ORDERED that respondent's June 20, 2017 motion to reopen the record is denied.

(Signed) Mark V. Holmes
Judge

Dated: Washington, D.C.
December 20, 2017