Sub - Holmes

UNITED STATES TAX COURT

WASHINGTON, DC 20217 PA

ESTATE OF MICHAEL J. JACKSON, Deceased, JOHN G. BRANCA, Co-executor and JOHN MCCLAIN, Co-executor,	)	
Petitioners,	)	Docket No. 17152-13.
v.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

ORDER

In February we held a trial in Los Angeles where the Jackson Estate and the Commissioner presented their cases. One of the issues was whether the Estate owed a penalty -- either the 20% accuracy-related penalty of I.R.C. § 6662(a) or the 40% gross-valuation-misstatement penalty of I.R.C. § 6662(h)(1) -- for reporting the value of the Estate's assets as it did on the estate-tax return. Both parties introduced a great deal of evidence on the value of several of those assets and the process by which the Estate prepared its return.

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.

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The Commissioner saw this coming. On June 27, 2017, he moved to reopen the record to add a penalty-approval form that he argues shows that he complied with I.R.C. § 6751(b)(1). The Estate objects.

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)).

The opening of *Graev* now reveals the first of these *Chai* ghouls, in a case presumptively appealable to the Ninth Circuit.

Background

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).[1] 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. So, after almost twenty years, it was finally time to give the section the attention it deserved.

In comes *Graev v. Commissioner*, 147 T.C. ___, ___ (Nov. 30, 2016) (*Graev II*) (slip op. at 24-39), where 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". Within four months, the Second Circuit rejected our holding in *Graev II*. *See Chai v. Commissioner*, 851 F.3d 190, 218-23 (2d Cir. 2017), *aff'g in part, rev'g in part* 109 T.C.M. 1206. Today, we adopt the Second Circuit's holding in

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[1] 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.

Chai as our own and roll it out to all the circuits. *See Graev III*, 149 T.C. at ___ (slip op. at 13-15).

In between *Graev II* and *Chai*, the Commissioner and the Estate completed discovery, held a trial, and jointly supplemented the record before the matter was closed and ready for briefing. But leading up to the trial -- and before we released *Graev II* -- the Estate made it clear to the Commissioner that it intended to put his compliance with I.R.C. § 6751(b)(1) at issue.

Before informal discovery was available, the Estate made a Freedom of Information Act (FOIA) request for the IRS's administrative file in June 2013 -- within weeks of the notice of deficiency. The FOIA response didn't include evidence of the IRS's compliance with I.R.C. § 6751(b)(1).

So when it finally had the chance, the Estate made an informal discovery request in June 2016:

> Please state whether Respondent complied with the procedural requirement set forth in I.R.C. Section 6751(b). If Respondent contends Section 6751(b) was complied with, please state each and every fact and reason, and provide all documents, relating to Respondent's contention.

To which the Commissioner replied:

> Respondent objects to this request on the grounds that it seeks to go behind the notice of deficiency.

But the Estate wasn't giving up. It reiterated its request in September 2016:

> Your response did not provide the requested information, instead objecting on the grounds that the request seeks to go behind the notice of deficiency. This request is within the scope of discovery, because Section 6751 is a statutory requirement independent of the notice of deficiency that Respondent must satisfy in order to be able to impose penalties. The doctrine Respondent is referring to does not excuse any non-compliance with Section 6751 and Respondent has

not cited any authority in support of its position. Accordingly, this request remains outstanding.

The second request did the trick; the Commissioner relented and gave the Estate the penalty-approval form the next day.

We issued *Graev II* two months later.

Pre-trial motions flooded in. And we set the trial for a special session in Los Angeles.

The parties came together to file a first joint stipulation of facts and exhibits at the end of January 2017. (They didn't stipulate to the Commissioner's compliance with I.R.C. § 6751(b)(1), and no penalty-approval form was among the exhibits.) The parties lodged a second joint stipulation of facts five days before trial, which we filed on the last day of trial subject to posttrial briefing on some issues about exhibits that might need to be sealed. (Once again, the parties didn't stipulate to the Commissioner's compliance with I.R.C. § 6751(b)(1); there were no exhibits with this one.)

The trial took place between February 6, 2017 and February 24, 2017. The Commissioner didn't present any evidence at trial that he had complied with I.R.C. § 6751(b)(1).

The Second Circuit released *Chai* less than a month after trial. In it, that court 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.

Posttrial motions flooded in. Because there were open housekeeping items after trial, we agreed to hold the record open so that the parties could submit a third stipulation of facts. The Estate wouldn't agree, however, to include the penalty-approval form in the third joint stipulation of facts, so we ordered the Commissioner to file a motion to reopen the record if he wanted to add evidence that he had complied with I.R.C. § 6751(b)(1).

The Commissioner now wants to add a penalty-approval form to the trial record; in support, he submitted an IRS supervisor's declaration to authenticate the document and show how the supervisor came to approve her subordinate's "initial determination." The form was electronically signed in May 2013 by a supervisory IRS estate-tax attorney named Ann Harper, and, according to Ms. Harper's declaration, it purports to approve an "initial determination" of penalties by a subordinate IRS estate-tax attorney named Mojgan Abrishami. But the form attached to the declaration nowhere mentions Ms. Abrishami; instead, it shows that an IRS employee named Anna Soliman filled out the form and refers to an explanation in an attached "penalty leadsheet."

There is no penalty leadsheet attached to the form, and the declaration nowhere explains who Ms. Soliman or *her* immediate supervisor is.

Should we reopen the record now to let the penalty-approval form in? The Estate says we shouldn't. Its first argument is that we shouldn't reopen the record because the Commissioner's failure to introduce the form at trial was a lack of diligence or, worse, a strategic decision that backfired -- and that the Commissioner's hindsight doesn't justify reopening the record. Its second contention is that we shouldn't reopen the record because there are "serious anomalies" in the form and supporting declaration. The Estate says that this means the additional evidence probably wouldn't change the outcome of the case, which is required for us to reopen the record under *Butler v. Commissioner*, 114 T.C. 276, 287 (2000), *abrogated on other grounds by Porter v. Commissioner*, 132 T.C. 203 (2009).

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). And the Ninth Circuit will not review our decision "except upon a demonstration of extraordinary circumstances which reveal a clear abuse of discretion." *Nor-Cal Adjusters v. Commissioner*, 503 F.2d 359, 363 (9th Cir. 1974) (citing *Friednash v. Commissioner*, 209 F.2d 601 (9th Cir. 1954); *Chiquita Mining Co. v. Commissioner*, 148 F.2d 306 (9th Cir. 1945)), *aff'g* 30 T.C.M. 837 (1971); *see also Devore v. Commissioner*, 963 F.2d 280, 282 (9th Cir. 1992), *rev'g and remanding Estate of Cole v. Commissioner*, 58 T.C.M. 715 (1989).

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 the Estate if we were to grant the motion to reopen the record. *See SEC v. Rogers*, 790 F.2d 1450, 1460 (9th Cir. 1986) (citing *Zenith Radio Corp.*, 401 U.S. at 332), *overruled on other grounds by Pinter v. Dahl*, 486 U.S. 622 (1988). "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 the 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*, 114 T.C. at 287. This second test is consistent with the Ninth Circuit's admonition that the trial court "should take into account, in considering a motion to hold open the trial record, the character of the additional [evidence] and the effect of granting the motion." *Rogers*, 790 F.2d at 1460. 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.

We'll consider diligence and prejudice first. The timeline here makes it difficult to evaluate the Commissioner's diligence. The unusual turn of events between *Graev II* and *Graev III* might normally justify reopening the record, but only if *Graev III* effects a change in the law that was a "reasonably genuine surprise." *See Romero v. City of Pomona*, 883 F.2d 1418, 1423 (9th Cir. 1989) (reopening the record may be justified by change in law that wasn't reasonably

anticipated by existing law and substantially affects burden of proof, but there must be "reasonably genuine surprise") (internal quotations omitted), *abrogated in part on other grounds by Townsend v. Holman Consulting Corp.*, 929 F.2d 1358, 1363 (9th Cir. 1991) (en banc); *Sequa Corp. v. GBJ Corp.*, 156 F.3d 136, 144-45 (2d Cir. 1998) (remanding to reopen the record so that plaintiff could present evidence for a legal interpretation adopted by the trial court *that neither party anticipated* during trial); *Du Pont v. United States*, 385 F.2d 780, 783-84 (3d Cir. 1967) (remanding for partial new trial so plaintiff could present additional evidence to replace evidence that was, *without warning at trial*, rejected by the trial court after the trial); *Halper v. Browning, King & Co.*, 325 F.2d 644, 645 (D.C. Cir. 1963) (remanding for new trial where "the case was tried under a misapprehension by the parties as to their respective burdens of proof," which was caused by the trial court's pretrial order).

The problem is that I.R.C. § 6751 has been in the Code for nearly 20 years. And our decision in *Graev III* today didn't create new law; it interpreted a section of the Code that was in existence at the time of the trial in this case, and we didn't say that our interpretation had only prospective effect. *See, e.g.*, *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 . . . announcement of the rule"); *Hajro v. U.S. Citizenship & Immigration Servs.*, 811 F.3d 1086, 1099 (9th Cir. 2016) (explaining that "[s]ilence on the issue [of prospectivity] indicates that the decision is to be given retroactive effect"). So 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 this case. The Commissioner should've reasonably anticipated this: The parties had a discovery dispute about I.R.C. § 6751(b)(1) months before the trial; the Commissioner had presented evidence that he had complied with I.R.C. § 6751(b)(1) in at least one case even before *Chai*, *see Legg*, 145 T.C. 344; and it was well known that the Second Circuit was considering the issue. We don't think the Commissioner was genuinely surprised. *See Romero*, 883 F.2d at 1423.

What happens if a party with the burden of production on an issue fails to introduce sufficient evidence at trial to meet that burden? Well, he loses. *See, e.g.*, *Wheeler v. Commissioner*, 127 T.C. 200, 210 (2006) (no I.R.C. § 6651(a)(2)

additions to tax where the Commissioner failed to introduce a substitute for return into evidence, because his burden of production required him to show that a return with the reported tax liability was filed for that year), *aff'd*, 521 F.3d 1289 (10th Cir. 2008). Which leads to the question here: What then happens if the party realizes his error after trial and moves to reopen the record to add evidence so that he can meet his burden? This depends on his diligence, as well as any prejudice to the nonmoving party if the record is reopened. *See supra* p. 6.

The Commissioner has a diligence problem here. The Estate made it clear months before the trial that it planned to raise I.R.C. § 6751(b)(1). But then -- before trial -- our Court did say that the Commissioner didn't need to show that he had complied with section 6751 in a deficiency case, *see Graev II*, 147 T.C. at ___ (slip op. at 39). This means that the Court may well have excluded the form (and the entire issue) from trial on the ground that it wasn't material; a ruling that would now be a legitimate target of a motion for reconsideration if we'd had a chance to rule on it at trial. But by not even trying to introduce the form and any related testimony, the Court wasn't given a chance to do so. And it's undisputed that the Commissioner *had* the penalty-approval form four months before trial, at a time when the continued vitality of *Graev II* hung in the balance while the Second Circuit reviewed the issue in *Chai*.

This made the form of reasonably foreseeable importance: Even when reasonable judges disagreed about section 6751's meaning, a prudent litigant should have at least made an offer of proof. This would then have allowed the Estate to make its own offer of proof highlighting what it contends are the weaknesses in the Commissioner's case on this issue. 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." *Locklin v. Switzer Bros., Inc.*, 299 F.2d 160, 169 (9th Cir. 1961). That is why the sound general rule is that we should deny a motion to reopen the record where the additional evidence was "readily available" at the time of trial, *see, e.g.*, *Merritt-Chapman & Scott Corp. v. Frazier*, 289 F.2d 849, 854 (9th Cir. 1961), particularly when granting the motion would prejudice the nonmoving party, *see, e.g.*, *Rogers*, 790 F.2d at 1460.

And we do agree with the Estate that it would be prejudiced -- it would lose a chance to examine and question the evidence as it would have at trial. *Estate of*

Freedman, 93 T.C.M. at 1013; *Megibow*, 87 T.C.M. at 991. On this point, the Estate makes a very convincing case. It has many problems with the Commissioner's additional evidence and tells us how it would've challenged the reliability of the evidence at trial. The Estate noticed, as we did, that Ms. Harper's declaration says that she approved Ms. Abrishami's "initial determination," but the penalty-approval form indicates that a Ms. Soliman made the determination. It points out that the penalty-approval form is dated 11 days before the notice of deficiency, which it says is an unlikely timeline "given that the notice of deficiency was issued by a separate branch of the examination division." And it takes issue with Ms. Harper's declaration, which identifies the subordinate who made the "initial determination" but then relies on the business-record rule -- rather than personal knowledge -- to authenticate the document.

We won't comment on the merits of each of the Estate's proposed challenges. But we do think the Estate should've had the chance to question Ms. Harper about these anomalies. *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"). Granting the Commissioner's motion would prejudice the Estate.

There is yet 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. The Commissioner hasn't met that burden either; the penalty-approval form and declaration are in conflict about the identity of the subordinate who made the "initial determination" -- i.e., the subordinate on the form is different from the subordinate who Ms. Harper avers *made* the "initial determination" of penalties. Although our Court still hasn't smoothed all the "initial determination" wrinkles, *see, e.g.*, *Graev III*, 149 T.C. at ___ (slip op. at 74-81) (Buch, J., concurring in part and dissenting in part), it's uncontroversial that the supervisor's written approval must be of the "initial determination" made by the same subordinate who *actually made* the "initial determination." Thus, even if we found that the Commissioner was diligent and the Estate wouldn't be unfairly prejudiced, we still wouldn't reopen the record because the form and declaration wouldn't change the outcome of the case.

It is therefore

ORDERED that respondent's June 27, 2017 motion to reopen the record is denied.

(Signed) Mark V. Holmes
Judge

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