UNITED STATES TAX COURT
WASHINGTON, DC 20217

CALVIN G. WALKER & STACY WALKER,	)	
	)	
Petitioner(s),	)	
	)	
v.	)	Docket No. 30216-13.
	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
	)	
Respondent	)	
	)	

ORDER

This order addresses and decides respondent's motion to reopen the trial record to allow the submission of evidence regarding the Internal Revenue Service's (IRS) compliance with section 6751(b)(1)[1] with respect to (1) section 6663 fraud penalties determined in the notice of deficiency against petitioners for tax years 2008, 2009, and 2010,[2] and, alternatively, (2) section 6662(a) accuracy-related penalties for the years at issue asserted against petitioners in respondent's first amendment to answer. We will grant the motion in that we will reopen the record, but, in order to eliminate any possible prejudice to any of the parties, we decline to rule on the admissibility of the evidence included in respondent's motion until the parties have had the opportunity (1) to develop the relevant facts with respect to the supervisory approval requirement of section 6751(b)(1) through informal consultation, see Rule 70(a), and, if necessary, formal discovery, and (2) to determine if a supplemental trial on the section 6751(b)(1) supervisory approval issue is necessary.

---

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

[2]For all purposes hereafter, years at issue will refer to petitioners' tax years 2008, 2009, and 2010.

SERVED Jul 10 2018

Background

Petitioners filed their petition in this case on December 26, 2013, challenging a notice of deficiency issued to petitioners by the IRS with respect to the years at issue. In the notice of deficiency, the IRS determined, among other things, that petitioners were liable for income tax deficiencies for each of the years at issue, attributable primarily to unreported Schedule C income, and that petitioners were liable for the section 6663 fraud penalty for each year. Respondent filed his initial answer, alleging facts in support of his fraud penalty determinations, which focused only on the actions of petitioner Calvin Walker, and petitioners filed a reply to that answer.

This case was first set for trial at a trial session in Houston, Texas, commencing on March 9, 2015. In January 2015, the attorney then representing both petitioners moved to withdraw from the representation of Mrs. Walker, and another attorney entered his appearance for Mrs. Walker. Petitioners moved for a continuance and respondent did not object. This Court granted the motion and continued the case. This case was again set for trial at a trial session in Houston, Texas, commencing on October 5, 2015. On July 9, 2015, respondent moved for leave to amend his answer, which the Court granted. Respondent's first amendment to answer asserted facts in support of the section 6663 fraud penalties with respect to both petitioners and asserted, in the alternative, the section 6662 accuracy-related penalty for each of the years at issue. Each petitioner filed a reply to the first amendment to answer. Neither of the petitioners nor respondent raised the section 6751(b)(1) supervisory approval issue in any of their pleadings or at any time before or after the trial, including the post-trial briefing.

This case was tried on October 7 and 8, 2015. At the end of the trial, this Court kept the record open to give petitioners the opportunity to produce additional documents for possible admission into evidence. By order dated January 6, 2016, the Court closed the record, and confirmed the briefing schedule. This case is currently under consideration by the Court.

After concessions, the only issue for decision is whether each petitioner is liable for civil fraud penalties under section 6663 for the years at issue. Petitioners have conceded that they are liable for the substantial understatement prong of the section 6662 accuracy-related penalty in the event that the Court determines the fraud penalty is not applicable for any of the years at issue.

On November 30, 2016, this Court issued its opinion in Graev v. Commissioner, 147 T.C. 460 (2016) (Graev II), holding that the question of whether the requisite supervisory approval of an initial determination of a penalty had been obtained pursuant to section 6751(b)(1) need not be addressed in a pre-assessment deficiency case because the penalty had not yet been assessed. Four months later, on March 20, 2017, the Court of Appeals for the Second Circuit held, in pertinent part, that section 6751(b)(1) requires written approval of the initial penalty determination no later than the date the IRS issues the notice of deficiency or files an answer or amended answer asserting such penalty and that compliance with section 6751(b)(1) was part of the Commissioner's burden of production in a deficiency case. Chai v. Commissioner, 851 F.3d 190, 221 (2d Cir. 2017) (Chai II), aff'g in part, rev'g in part Chai v. Commissioner, T.C. Memo. 2015-42 (Chai I) (taxpayer's attempt to raise section 6751(b) issue was untimely). Nine months later, this Court held to the same effect as to the burden of production, in Graev v. Commissioner, 149 T.C.__ (Dec. 20, 2017) (Graev III), overruling this Court's prior contrary holding in Graev II.

By order dated December 28, 2017, this Court raised sua sponte the section 6751(b)(1)issue and ordered the parties to file responses. The Court also directed the parties by January 26, 2018, to file any motion with respect to the section 6751(b)(1) issue. Each party filed a timely response and respondent filed a timely motion to reopen the record to receive evidence with respect to the section 6751(b)(1) supervisory approval requirement as interpreted in Graev III. Respondent attached to the motion to reopen the record (1) a Declaration of M. Kathryn Bellis, that purports to authenticate and offer into evidence a Civil Penalty Approval Form, dated July 2, 2013 (copy attached), purportedly signed by Revenue Agent Timothy Johnson's immediate supervisor, Melvin Doolan, approving the assertion of the section 6663 fraud penalty against the petitioners for the years at issue, and (2) a Declaration of Gordon P. Sanz, the immediate supervisor of the attorney who proposed asserting the section 6662 accuracy-related penalty as an alternative to the section 6663 fraud penalty in the first amendment to answer, confirming that he had approved the assertion of the penalties as set forth in the first amendment to answer.

In their responses to the motion to reopen the record, petitioners oppose the motion for several reasons. Citing a Tax Court memorandum opinion, Snuggery-Elvis P'ship v. Commissioner, T.C. Memo. 1992-622 (Snuggery-Elvis), petitioners contend that, in order to prevail on a motion to reopen a record, the moving party must show that the evidence to be presented was not available for use at the original trial or could not have been obtained with reasonable diligence.

Petitioners also contend that reopening the record and summarily admitting the proffered evidence without further trial would prejudice them because they would be denied the opportunity to examine witnesses and contest the admissibility of documents offered to prove section 6751(b)(1) compliance.

Discussion

Congress added section 6751 as part of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, sec. 3306, 112 Stat. at 685, 744. It is effective for notices issued after June 30, 2001. Pub. L. No. 106-554, sec. 302(b), Dec. 21, 2000, 114 Stat. at 2763. Section 6751(b)(1) provides that "No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate."

Until recently, there had been little litigation over the application and interpretation of section 6751(b)(1) with respect to pre-assessment deficiency cases. See Legg v. Commissioner, 145 T.C. 344 (2015) (Legg). In Chai I, an opinion issued on March 11, 2015, the Court held that the taxpayer had not timely raised the section 6751(b)(1) issue because he did so after the record had closed. Although the trial in this case occurred several months after the release of Chai I, petitioners did not raise the section 6751(b)(1) issue at any point after March 11, 2015, and before trial in October 2015, nor did they raise or argue the issue in their post-trial briefs.

After trial in this case was concluded, but before the record was closed, this Court issued a Division Opinion, Legg, in which the Court concluded that the supervisory approval requirement of section 6751(b)(1), even if applicable to a pre-assessment deficiency case, had been satisfied. Even after the Court issued its opinion in Legg, petitioners did not take steps to raise or brief the section 6751(b)(1) issue.

After the record was closed in this case and the post-trial briefing was completed, this Court in a divided, Court-reviewed opinion, Graev II, held that the taxpayer's argument under section 6751(b)(1) was premature because the section 6662 accuracy-related penalty at issue in Graev v. Commissioner, 140 T.C. 377 (2013) had not yet been assessed. Because of the Court's holding in Graev II, neither petitioners nor respondent had any reason to assert or argue the section 6751(b)(1) issue in this case and they did not seek to do so.

After the Court of Appeals for the Second Circuit reversed Chai I, this Court reconsidered its position in Graev II, and in yet another divided, Court-reviewed opinion issued on December 20, 2017, Graev III, held that proof of compliance with the supervisory approval requirement of section 6751(b)(1) was part of the Commissioner's burden of production with respect to penalties under section 7491(c).

No party in this case raised section 6751(b)(1) as an issue until ordered to do so by the Court on December 28, 2017. While the IRS was on notice that it had an obligation to obtain supervisory approval before assessing a penalty, section 6751(b)(1)'s use of the term "assessed" to anchor the obligation created an extraordinarily ambiguous provision that was exceedingly difficult to parse and apply as evidenced by the two Court-reviewed opinions issued by this Court. Because of that difficulty and because each of the parties in this case failed to affirmatively raise the section 6751(b)(1) issue at any point during these proceedings until they were required to do so by this Court, this Court, in the exercise of its discretion, will give all parties the opportunity to address the issue and to supplement the record through a supplemental stipulation of facts and/or a supplemental trial, if necessary.

Reopening the record for the submission of additional evidence is a matter within the discretion of the trial court. Zenith Radio Corp. v. Hazeltine Research, Inc., 401 U.S. 321, 331 (1971); Butler v. Commissioner, 114 T.C. 276, 286-287 (2000). This Court will grant a motion to reopen the record only if "the evidence relied on is not merely cumulative or impeaching, the evidence is material to the issues involved, and the evidence probably would change the outcome of the case." Butler v. Commissioner, 114 T.C. at 287.

The evidence that is the subject of respondent's motion would not be cumulative of any evidence in the record nor would it impeach or contradict evidence that is currently in the record. And, respondent must introduce evidence that the section 6663 fraud penalty was approved as required by section 6751(b)(1) in order to satisfy his initial burden of production under section 7491(c), as this Court's opinion in Graev III holds. Because there is no evidence currently in the record to prove whether the supervisory approval requirement of section 6751(b)(1) has been met with respect to the contested fraud penalties, the introduction of penalty approval evidence likely would change the outcome as to the only issue remaining in this case. The standard for reopening the record as articulated by this Court in Butler v. Commissioner, 114 T.C. at 287, is satisfied.

Finally, we turn to petitioners' argument that the threshold rule for reopening the record for submission of new evidence is that the evidence sought to be submitted was not available for use in the original trial, which relies upon this Court's memorandum opinion in Snuggery-Elvis. The Court in Snuggery-Elvis dealt with a situation where the taxpayers failed to comply with multiple requests for records, failed to answer interrogatories, and failed to respond to a Court order directing them to comply with discovery requests. The petitioners in Snuggery-Elvis had control of the records in question and should have produced them in response to discovery requests. When the taxpayer attempted to offer the records after the trial record had closed, the Court declined to exercise its discretion to allow the petitioners to supplement the record because they made "no reasonably diligent effort. . . to obtain the evidence" prior to trial, despite being ordered to do so by this Court. Snuggery-Elvis at 6. Snuggery-Elvis is distinguishable.

Upon due consideration, it is hereby

ORDERED that respondent's January 22, 2018 motion to reopen the record is granted in that the record is reopened for the purpose of receiving evidence, either in the form of a supplemental stipulation of facts or by way of a supplemental trial regarding the section 6751(b)(1) penalty approval requirement and whether it is met in this case. It is further

ORDERED that the parties shall have until September 17, 2018, to engage in the informal exchange of information as required by Rule 70, and, if the section 6751(b)(1) issue cannot be developed and resolved informally, to complete formal discovery. It is further

ORDERED that on or before October 1, 2018, the parties shall submit a joint status report advising the Court of the status of this matter and whether there is a need for a supplemental trial in this case with respect to respondent's compliance with section 6751(b)(1).

(Signed) L. Paige Marvel
Judge

Dated: Washington, D.C.
July 9, 2018