UNITED STATES TAX COURT
WASHINGTON, DC 20217

ERNEST S. RYDER & ASSOCIATES, INC., APLC, ET AL.,		
Petitioner(s),		
v.	Docket No.	14619-10, 14687-10, 7527-12, 9921-12, 9922-12, 9977-12, 30196-14, 31483-15.
COMMISSIONER OF INTERNAL REVENUE,		
Respondent		

O R D E R

These cases were tried in two special trial sessions in 2016: one in San Diego from July 25 to August 3, and another in Phoenix from August 22 to August 26. They include petitioners of all different shapes and sizes -- C corporations, a TEFRA partnership, and individuals -- and in all but two of the cases the Commissioner asserted IRC § 6662 accuracy-related and/or IRC § 6663 fraud penalties. Briefing is underway and, before it's completed, the Commissioner asks that we reopen the record to let in evidence that he says shows he complied with IRC § 6751(b)(1) for *some* of these penalties.[1] Petitioners object.

[1] The Commissioner concedes the § 6663 fraud penalties that he asserted against the Ryders in their case at docket number 31483-15, "because [he] could not find sufficient evidence to satisfy his burden of production under I.R.C. § 7491(c) with respect to compliance with I.R.C. § 6751(b)(1)" for those penalties. For some of the § 6662 accuracy-related penalties that he determined against the Ryders in notices of deficiency, the Commissioner says that evidence of his compliance with § 6751(b)(1) is already in the trial record. Finally, the Commissioner focuses in his motion only on penalties asserted against the Ryders individually because, he explains, he doesn't have the burden to show compliance with § 6751(b)(1) for penalties asserted against a C corporation or a TEFRA partnership. *See Dynamo Holdings Ltd. P'ship v. Commissioner*, 150 T.C. ___, ___ (slip op. at 13, 21) (May

As if these cases weren't complicated enough, now a *Chai* ghoul rears its head. *See Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 2017), *aff'g in part, rev'g in part* 109 T.C.M. 1206, and *Graev v. Commissioner* (*Graev III*), 149 T.C. ___ (Dec. 20, 2017), *supplementing and overruling in part* 147 T.C. 460 (2016). This species involves documentation that we've not seen the Commissioner offer in any other case.

Background

We'll start with the timeline:

> March 26, 2010 -- The Commissioner determined tax deficiencies and § 6662 accuracy-related penalties against the Ryders for their joint 2002-04 tax years. (The Commissioner did not determine any § 6663 fraud penalties against the Ryders in the notice of deficiency.)
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> January 17, 2012 -- The Commissioner determined tax deficiencies and § 6662 accuracy-related penalties against the Ryders for their joint 2005-09 tax years. (The Commissioner did not determine any § 6663 fraud penalties against the Ryders in the notice of deficiency.)
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> September 18, 2014 -- The Commissioner determined a tax deficiency and a § 6662 accuracy-related penalty against the Ryders for their joint 2010 tax year. (The Commissioner did not determine any § 6663 fraud penalties against the Ryders in the notice of deficiency.)

7, 2018); *see also NT, Inc. v. Commissioner*, 126 T.C. 191, 195 (2006). (We note, but won't comment on further, that the Commissioner raised some of those penalties for the first time in amended answers.)

March 21, 2016 -- The Commissioner in amended answers raised for the first time § 6663 fraud penalties against the Ryders for their joint 2002-10 tax years.

July 25, 2016 - August 3, 2016, and August 22, 2016 - August 26, 2016 -- Trial. At the trial the Commissioner did not introduce any evidence of his compliance with § 6751(b)(1) for the § 6662 accuracy-related penalties that he determined against the Ryders for their 2005-09 tax years or any of the § 6663 fraud penalties; the parties also never stipulated to his compliance.

November 30, 2016 -- We issued *Graev v. Commissioner* (*Graev II*), 147 T.C. 460, 475-85 (2016), where we held that compliance with § 6751(b)(1) is not ripe for review in a preassessment deficiency case because the penalty has not yet been "assessed".

March 20, 2017 -- The Second Circuit held in *Chai*, 851 F.3d at 218-23, that we were wrong in *Graev II* and that the Commissioner had to show that he complied with § 6751(b)(1) as part of his burdens of production and proof on penalties under § 7491(c) in deficiency cases.

June 17, 2017 -- The Commissioner filed his seriatim opening brief. Up to this point, neither party had said anything about the Commissioner's compliance (or lack thereof) with § 6751. The Commissioner's opening brief didn't say anything about it either.

October 26, 2017 -- The Commissioner filed his first amended seriatim opening brief. He still said nothing about his compliance (or lack thereof) with § 6751.

December 20, 2017 -- We adopted the Second Circuit's holding in *Chai* as our own in *Graev III*, 149 T.C. at ___ (slip op. at 13-15).

January 11, 2018 -- Due to the complexity of the cases and the extraordinary length of the Commissioner's opening brief, we gave petitioners more time -- until May 1, 2018 -- to file their answering brief.

April 26, 2018 -- We granted another motion to extend the time for petitioners to file their answering brief until July 2, 2018.

June 4, 2018 -- The Commissioner moved to reopen the record.

June 27, 2018 -- We granted yet another motion to extend the time for petitioners to file their answering brief until September 10, 2018.

The Commissioner wants to add to the record:

> a "redacted Examination Case Processing Sheet (Form 3198)" that he says "was executed when the audit was complete (and before the notice of deficiency was issued)" for the audit in which the Commissioner determined tax deficiencies and § 6662 accuracy-related penalties against the Ryders for their joint 2005-09 tax years;
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> an "email from Hans F. Famularo, together with an attached amendment to answer raising fraud" in the cases against the Ryders for their joint 2002-10 tax years;
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> a "redacted Significant Case Report prepared by Mr. Famularo notifying IRS counsel executives" that he and IRS trial counsel Kevin Coy planned to allege fraud in the cases against the Ryders for their joint 2002-10 tax years; and
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> "the first two pages of Mr. Coy's redacted 2016 evaluation," which, the Commissioner argues, "shows Mr. Famularo was Mr. Coy's immediate supervisor" during the period of time that Mr. Coy made "the initial determination that fraud should be asserted."

In support of his motion, the Commissioner submitted declarations from IRS revenue agent Huong T. Phan and IRS associate area counsel Hans F. Famularo.

Ms. Phan says in her declaration that she initially determined § 6662 penalties against the Ryders, "prepared the Examination Case Processing Sheet . . . used to close the audit," and "John A. Consoli (my immediate supervisor) signed [the document] personally approving, in writing, the initial determination to assert the IRC § 6662 penalties." The Examination Case Processing Sheet itself lists

Ms. Phan as the "Employee Preparing Form," and appears to have been signed by Mr. Consoli on October 7, 2011.

Mr. Famularo says in his declaration that he "personally approved, in writing, the initial determination to assert IRC § 6663 penalties" in the cases against the Ryders for their 2002-10 tax years "by sending to Senior Counsel, Kevin Coy and Attorney, Blake Corry, an email with an attachment containing [his] revisions to the proposed amendments to answer alleging fraud." He then says he sent his supervisors "a Significant Case Report [for the Ryders' cases] confirming [his] approval to assert IRC § 6663 penalties" and that he's the one who signed Mr. Coy's 2016 employee evaluation. A blank email, a draft amended answer, a redacted "Significant Case Report," and a redacted "Performance Appraisal Form" are attached to Mr. Famularo's declaration.

Should we reopen the record to admit this additional evidence? The Ryders say we shouldn't. They argue that the Commissioner's "ignorance of the law is no excuse to reopen the record" -- that the Commissioner had plenty of notice that § 6751(b)(1) would be an issue in these cases, and his failure to introduce evidence of compliance with that section at trial shows a lack of diligence. The Ryders also say they would be prejudiced if we reopened the record now to admit the Commissioner's proffered evidence because they have not had the chance to cross-examine Ms. Phan or Mr. Famularo and the "declarations are conclusory and self-serving." They also point out that the evidence the Commissioner is offering here is unusual in that it differs, for example, from the penalty-approval forms that the Internal Revenue Manual contemplates. The Ryders argue that, "without non-evidentiary inferences and conjecture," the proffered evidence "does not make a prima facie showing that Respondent satisfied the requirements of § 6751(b)(1) or that it would change the outcome of the case, absent a new trial."

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 -- to which these cases are presumably appealable -- 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).

But our discretion is not unbounded. We won't reopen the record unless the evidence that the Commissioner 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); *see also SEC v. Rogers*, 790 F.2d 1450, 1460 (9th Cir. 1986) (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"), *overruled on other grounds by Pinter v. Dahl*, 486 U.S. 622 (1988).

Even if the evidence is material and would change the outcomes of these cases, we still need to 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 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) ("[p]roper 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 "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).

A. § 6662 Penalties for 2005-09 Tax Years

We'll start with the evidence that the Commissioner wants added to the record for penalties that he determined in notices of deficiency: the "redacted Examination Case Processing Sheet (Form 3198)" that he says "was executed when the audit was complete (and before the notice of deficiency was issued)."

Is this evidence admissible? In the fallout from *Graev III*, the Commissioner has sought to reopen the record in many pending cases. He usually wants to admit a penalty-approval form to show that an initial determination of penalties was approved in writing by an IRS examiner's supervisor. In some earlier orders, we found that penalty-approval forms were admissible under the business-records exception to hearsay, *see* Fed. R. Evid. 803(6); more recently, we've found that the forms were verbal acts, admissible to show that the supervisor approved the penalty, not that the penalty was justified or even what the supervisor was thinking when he approved it, *see* Fed. R. Evid. 801(c) advisory committee's note ("[i]f the significance of an offered statement lies solely in the fact that it was made, no issue is raised as to the truth of anything asserted, and the statement is not hearsay"). We can't say that the verbal-act analysis applies here. While the Examination Case Processing Sheet does appear to be signed by Ms. Phan's manager and does have penalty amounts listed on it, the document itself doesn't give any indication on its face that it has anything to do with a supervisor approving Ms. Phan's initial determination of penalties. Indeed, if it wasn't for Ms. Phan's declaration, it would be entirely unclear to us why the Commissioner wants the Examination Case Processing Sheet in the record.[2]

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[2] The Commissioner recently moved for leave to file a reply to petitioners' response to the Commissioner's first amended motion to reopen the record. We'll grant his motion here, and we considered his additional arguments in disposing of his amended motion to reopen the record. One of those arguments focused on a recent Fifth Circuit opinion, *PBBM-Rose Hill, Ltd. v. Commissioner*, No. 17-60276, 2018 WL 3853450, at *13-*14 (5th Cir. Aug. 14, 2018), which held that the "managerial-approval requirement was fulfilled by a managerial signature on the cover letter of a summary report on the examination . . . that included the 'Gross Valuation Overstatement Penalty Issue Lead Sheet.'" We note that the evidence the Commissioner offers here is nothing like the evidence admitted in *PBBM-Rose Hill, Ltd.* -- it doesn't indicate on its face a determination of penalties by a subordinate and their approval by a supervisor. Also, the Commissioner wants this evidence admitted *after* the trial, and it is evidence that requires testimonial clarification not provided at trial.

On that part the Commissioner has a problem, because Ms. Phan's declaration is 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)). It is offered for the truth of the matters asserted in it -- that Ms. Phan initially determined § 6662 penalties against the Ryders as part of her examination of their 2005-09 tax years, and Mr. Consoli signed the Examination Case Processing Sheet to personally approve of that initial determination in writing. And, unlike the Examination Case Processing Sheet itself, which might come in under the business-records exception to hearsay, *see* Fed. R. Evid. 803(6), Ms. Phan's declaration can't satisfy that exception: It was prepared more than six years after the Examination Case Processing Sheet, and it doesn't appear to be a document that is kept in the course of a regularly conducted activity of the IRS.

The Examination Case Processing Sheet is at best ambiguous without Ms. Phan's declaration, and Ms. Phan's declaration can't come into evidence because it is inadmissible hearsay. The additional evidence would therefore not change the outcome of the case, and we will not reopen the record to admit it. *See Butler v. Commissioner*, 114 T.C. at 287; *Rogers*, 790 F.2d at 1460.

B. § 6663 Penalties for 2002-10 Tax Years

The rest of the penalties at issue here were asserted for the first time by the Commissioner in amended answers, and for those the Commissioner wants to add to the record: an email from IRS associate area counsel Hans F. Famularo with an attached amendment to answer raising fraud in the Ryders' cases for their 2002-10 tax years; a redacted Significant Case Report by Mr. Famularo alerting his supervisors about the amended answer; and Mr. Coy's redacted 2016 employee evaluation.

This evidence is also inadmissible. The blank email, draft amendment to answer, Significant Case Report, and employee evaluation that the Commissioner wants in the record mean absolutely nothing to us without some explanation. Once again, the Commissioner's explanation comes in the form of a declaration and, once again, that declaration is inadmissible hearsay. *See* Fed. R. Evid. 801(c), 802; *see also, e.g.*, *Paradiso*, 90 T.C.M. at 113; *Woodall*, 84 T.C.M. at 703 n.6. As is Ms. Phan's declaration, Mr. Famularo's is offered for the truth of the matters asserted in it -- that he "personally approved, in writing, the initial determination to assert IRC § 6663 penalties . . . by sending to Senior Counsel, Kevin Coy and

Attorney, Blake Corry, an email with an attachment containing [his] revisions to the proposed amendments to answer alleging fraud," and that he confirmed that approval in the Significant Case Report. Unlike the draft amendment to answer or the Significant Case Report themselves, which might come in under the business-records exception to hearsay, *see* Fed. R. Evid. 803(6), Mr. Famularo's declaration can't satisfy that exception: It was prepared more than two years after the email and draft amendment to answer, and it doesn't appear to be a document that is kept in the course of a regularly conducted activity of the IRS.

The evidence that the Commissioner wants admitted to show supervisory approval for the initial determination of § 6663 penalties is at best ambiguous without Mr. Famularo's declaration, and his declaration can't come into evidence because it is inadmissible hearsay. The additional evidence would therefore not change the outcome of the case, and we will not reopen the record to admit it. *See Butler v. Commissioner*, 114 T.C. at 287; *Rogers*, 790 F.2d at 1460.

The questions of the Commissioner's diligence (or lack thereof) in introducing evidence at trial, and any prejudice to the petitioners if we were to grant a motion to reopen the record, are always difficult ones to answer. We won't get to those questions today, though, because the Commissioner hasn't shown that the proffered evidence would change the outcome of these cases.

It is therefore

ORDERED that respondent's motion for leave to file reply to petitioners' response to respondent's first amended motion to reopen the record is granted. It is also

ORDERED that respondent's June 4, 2018 amended motion to reopen the record is denied.

(Signed) Mark V. Holmes
Judge

Dated: Washington, D.C.
August 27, 2018