Sub. Holmes

**UNITED STATES TAX COURT**

PA

**WASHINGTON, DC 20217**

| | | |
|---|---|---|
| KUMAR RAJAGOPALAN & SUSAMMA KUMAR, et al., | ) | |
| Petitioners, | ) | |
| v. | ) | Docket Nos. 21394-11, 21575-11. |
| COMMISSIONER OF INTERNAL REVENUE, | ) | |
| Respondent. | ) | |

**ORDER**

These consolidated cases were tried during the Court's June 2015 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 200% 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 July 6, 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 second of four similar motions we decide today forces us to face yet another of these *Chai* ghouls -- this one with a unique grimace -- in a case presumptively appealable to the Eleventh Circuit.

**Background**

The petitions in these cases were filed in September 2011. A few years went by while we waited for the automatic stay to be lifted in a Chapter 7 bankruptcy that one of the petitioners had filed. But we eventually consolidated the cases in January 2015 -- they involve the same non-TEFRA partnership -- and set the case for trial.

With the cases now going to trial, important filings started coming in. The Commissioner filed motions for leave to amend his answers in May 2015 -- less than a month 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 whether 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)."

Days 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 said that petitioners weren't prejudiced by being deprived of a procedural defense under I.R.C. § 6751(b) because that section wasn't relevant in deficiency cases -- no assessment had yet occurred.

The parties filed a first joint stipulation of facts and exhibits on the day trial began in June 2015. 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 the same day. 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 on June 9, 2015. The Commissioner didn't present any evidence at trial that he had complied with I.R.C. § 6751(b)(1).

A few days after the trial, the Court became aware of *Graev II*. So we invited "petitioners to include any arguments for reconsideration of this division's June 5 orders in their posttrial briefs." Petitioners accepted our invitation. When they filed their opening brief in September 2015, they devoted several pages to the requirements of I.R.C. § 6751(b). And they said that the Commissioner had "presented no evidence of any written managerial approval of any 'initial determination' to impose gross valuation misstatement penalties."

The Commissioner responded to petitioners' challenge a couple months later. In his answering brief 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 the requirements of I.R.C. § 6751(b) "have already been met in this case" because the IRS Chief Counsel lawyer's "initial determination" of the gross-valuation-misstatement penalties was approved by his immediate supervisor. That, he said, "is evidenced by [the IRS Chief Counsel supervisor's] electronically-signed approval of the amendment to answer."

So the Commissioner had volleyed the issue back to petitioners. In their reply brief, petitioners focused on a penalty-approval form that they had obtained through a Freedom of Information Act request. The form hasn't been admitted into evidence, but petitioners argued that it shows the Commissioner failed to comply with I.R.C. § 6751(b). Because that form hasn't been admitted into evidence, we won't comment further on petitioners' argument. Suffice it to say, the I.R.C. § 6751(b) issue had been briefed in a fair amount of detail -- by both sides -- as of December 2015.

We issued *Graev v. Commissioner*, 147 T.C. ___ (Nov. 30, 2016) (*Graev II*), almost one year 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). And only a few 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).

Four months 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 two years ago in his answering brief that evidence of I.R.C. § 6751(b)(1) compliance is already in the record. More specifically, he said that written supervisory approval of the IRS Chief Counsel lawyer's "initial determination" of gross-valuation-misstatement penalties is "evidenced by [the IRS Chief Counsel supervisor's] electronically-signed approval of the amendment to answer." 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 supervisor's declaration to the record.[1] The declaration explains that the IRS Chief Counsel supervisor is the immediate supervisor of the IRS Chief Counsel lawyer who is assigned to this case; that he agreed with the IRS Chief Counsel lawyer's "initial determination" to move to amend the pleadings in order to assert the gross-valuation-misstatement penalties; and that he approved that "initial determination" in writing by typing his initials on the motions for leave to file

[1] We note that it seems the IRS Chief Counsel supervisor also approved the IRS Chief Counsel lawyer's determination to move to reopen the record -- his initials are typed on the motion at issue here as well.

amendments to answers and the amendments to answers. The initialed amendments to answers are attached to the declaration.

Should we reopen the record now to let the declaration 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 supervisor testify at trial shows a lack of diligence or, worse, "a calculated risk" that didn't work out, and petitioners would be prejudiced if the declaration was admitted into evidence now when they don't have the opportunity to cross-examine the supervisor. Petitioners' second argument is that we shouldn't reopen the record to admit the declaration because it's 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.

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);

---

[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 the Fifth Circuit's 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.

*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 answering 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 year after we held the trial in this case and the Commissioner filed his answering brief. That weakens the Commissioner's excuse, especially when we told him and petitioners within days of the trial that we would welcome I.R.C. § 6751(b) arguments in the briefs 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 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.

---

[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.

*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 less reason not to have anticipated this here than in most cases: Petitioners raised § 6751(b)(1) before trial in their response to the Commissioner's motion for leave to amend his answers, 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 submitted for decision, *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 supervisor to testify, which also makes his failure look like a lack of diligence.

This 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 supervisor to testify at trial petitioners could have cross-examined him. 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 declaration -- 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 argue that "[t]he Declaration is a self-serving statement prepared . . . over two years after the trial in these consolidated cases concluded." Petitioners also noticed that, although the declaration indicates that the IRS Chief Counsel supervisor's initials were typed on the motions for leave to amend and the amended answers, "those initials do not appear on the filed copy of the motion in Docket No. 21575-11." And they correctly state that they can't cross-examine a piece of paper.

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 supervisor. *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 declaration is inadmissible hearsay. *See* Fed R. Evid. 801(c), 802; *see, 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 does argue that the declaration is admissible under the business-records exception to hearsay, *see* Fed. R. Evid. 803(6), but we can't agree: It was prepared years after the amended answers and doesn't appear to be a document that is kept in the course of a regularly conducted activity of the IRS. And it *is* offered here for the truth of the matters asserted in it -- 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 declaration because it's inadmissible hearsay.

It is therefore

ORDERED that respondent's July 6, 2017 motion to reopen the record is denied.

**(Signed) Mark V. Holmes**
**Judge**

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