

UNITED STATES TAX COURT
WASHINGTON, DC 20217

BLOSSOM DAY CARE CENTERS, INC., ET)	
AL.,)	
)	
Petitioners,)	
)	
v.)	Docket Nos. 3868-12, 3869-12,
)	3870-12.
COMMISSIONER OF INTERNAL REVENUE,)	
)	
Respondent)	

ORDER

This case was submitted after trial on June 23, 2016, and remains under consideration by the Court. On December 20, 2017, the Court issued its opinion in Graev v. Commissioner, 149 T.C. __ (December 20, 2017), and issues addressed in that opinion may affect this case. This order sets a limited time for the parties to make additional arguments they deem appropriate in the light of the Court's recent opinion in Graev.

Congress added section 6751 as part of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, sec. 3306, July 22, 1998, 112 Stat. 685, 744 (RRA'98). It is effective for notices issued after December 31, 2000. Sec. 3306(c). Section 6751(b)(1) provides:

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 effect of section 6751(b). The Court will address the recent litigation chronologically.

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The earliest case of note¹ is Chai v. Commissioner, T.C. Memo. 2015-42, rev'd, 851 F.3d 190 (2nd Cir. 2017). In that case, Mr. Chai did not raise any questions regarding the application of section 6751(b) until he submitted his posttrial brief. Chai stands for the proposition: “A party may not raise an issue for the first time on brief if the Court’s consideration of the issue would surprise and prejudice the opposing party.” Chai v. Commissioner, T.C. Memo. 2015-42, at *25.

The Court’s first case to address section 6751(b) where supervisory approval was required was Legg v. Commissioner, 145 T.C. 344 (2015). In that case, the taxpayer challenged the application of a 40% gross valuation misstatement penalty, alleging that the Commissioner failed to get supervisory approval of the initial determination as required by section 6751(b). On the facts of that case, the Court held that the requirement for supervisory approval was satisfied. The Court did not need to reach the issue of when approval must occur because the penalty was approved as part of the examination report. The Court expressly left open the question of when supervisory approval was required. Id. at 349.

Then came Graev v. Commissioner, 147 T.C. ___ (November 30, 2016). In Graev, the Court split on the question left open by Legg: when supervisory approval of a penalty determination is required. A majority of the Court held that the question of whether the requisite supervisory approval was obtained was premature because the tax had not yet been assessed. In effect, the majority held that supervisory approval could occur at any time before assessment. The dissenters argued not only that the issue of supervisory approval was ripe for consideration, but that demonstrating supervisory approval was part of the Commissioner’s burden of production. See Graev v. Commissioner, 147 T.C. at ___ (slip op. at 76); see also sec. 7491(c).

That dissent figured prominently in the U.S. Court of Appeals for the Second Circuit’s reversal of Chai. See Chai v. Commissioner, 851 F.3d 190, 216-

¹Although there were earlier cases that addressed section 6751(b), they principally dealt with penalties that were automatically calculated through electronic means, thus the issue of supervisory approval was immaterial. See, e.g., Grace Found. v. Commissioner, T.C. Memo. 2014-229, at *14; see also sec. 6751(b)(2).

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220 (2nd Cir. 2017), rev'g, T.C. Memo. 2015-42. On March 20, 2017, the Court of Appeals reversed Chai specifically on the issue of the application of section 6751(b). In addition to quoting extensively from the Graev dissent, the Court of Appeals held “that § 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. In that vein, we further hold that compliance with § 6751(b) is part of the Commissioner’s burden of production and proof in a deficiency case in which a penalty is asserted.” Id. at 221.

When the Court of Appeals issued its opinion in Chai, the decision in Graev was not yet final. On March 24, 2017, the Commissioner moved to vacate the decision in Graev to allow for supplemental briefing regarding section 6751(b). The Court granted the motion, and on December 20, 2017, the Court issued its latest opinion in Graev, 149 T.C. ___ (December 20, 2017). Consistent with the U.S. Court of Appeals for the Second Circuit,² the Court held that the Commissioner’s burden of production under section 7491(c) includes establishing compliance with the supervisory approval requirement of section 6751(b).

The question before us is how Graev might affect this case. In this regard, a timeline may be helpful.

- Section 6751 enacted (July 22, 1998)
- Section 6751 effective (notices issued after December 31, 2000)
- Chai v. Commissioner, T.C. Memo. 2015-42 (March 11, 2015)
- Legg v. Commissioner, 145 T.C. 344 (December 7, 2015)
- Partial trial held (March 29-31, 2016)
- Case submitted after further trial (June 23, 2016)
- Graev v. Commissioner, 146 T. C. No. 16 (November 30, 2016)
- Respondent’s Simultaneous Opening Brief filed (December 14, 2016)

²Graev is appealable to the U.S. Court of Appeals for the Second Circuit, which decided Chai. However in deciding Graev, the Court did not rely on Golsen v. Commissioner, 54 T.C. 742 (1970). No other Court of Appeals has addressed the application of section 6751(b), thus at this time, the Court’s holding in Graev applies regardless of the circuit to which any particular case may be appealable.

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- Chai v. Commissioner, 851 F.3d 190 (2nd Cir. March 20, 2017)
- Petitioners' Simultaneous Opening Brief filed (June 5, 2017)
- Graev v. Commissioner, 149 T.C. No. 23 (December 20, 2017)
- Simultaneous Answering Briefs due January 2, 2018
- Simultaneous Reply Briefs due February 28, 2018

On October 6, 2017, respondent filed a Motion to Reopen the Record to address the effect of section 6751(b) on this case and direct the Court to any evidence of section 6751(b) supervisory approval that is in the record of the case. Respondent also attached to his motion exhibits regarding section 6751(b) supervisory approval and moved that those exhibits be admitted into evidence.

On November 9, 2017, petitioners filed a Response to Motion to Reopen the Record addressing the effect of section 6751(b) supervisory approval on this case and objecting to respondent's proposed exhibits being admitted into evidence. On November 30, 2017, respondent filed a Reply to petitioners' Response.

To assist the Court in addressing this issue, it is

ORDERED that, on or before January 12, 2018, petitioners shall file a Sur-Reply to respondent's Reply to Response to Motion to Reopen the Record. It is further

ORDERED that the Simultaneous Answering Briefs are extended to January 31, 2018.

(Signed) Elizabeth Crewson Paris
Judge

Dated: Washington, D.C.
December 21, 2017