UNITED STATES TAX COURT
WASHINGTON, DC 20217

BENJAMIN SOLEIMANI & SHARYN SOLEIMANI,	)	
Petitioners,	)	
v.	)	Docket No. 8884-13.
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	

O R D E R

Respondent has moved, pursuant to Rule 50,[1] that the Court reopen the record for the purpose of allowing him to submit evidence to establish that he satisfied the requirements of section 6751(b)(1) in determining a section 6662 accuracy-related penalty with respect to petitioners' Federal income tax for the 2007 taxable year. Petitioners object. Respondent's original motion, filed January 22, 2018, contained a drafting error. He filed an amended motion on July 31, 2018. We will grant respondent's amended motion in part, and deny it in part, as set forth below.

Background

In a notice of deficiency dated January 23, 2013, respondent determined a deficiency of $414,193 and a section 6662(a) accuracy-related penalty of $82,839 for 2007. Respondent determined that petitioners are liable for the accuracy-related penalty on the portion of any underpayment attributable to a substantial understatement of income tax.[2] See sec. 6662(a), (b)(2), (d).

[1]Unless otherwise noted, all Rule references are to the Tax Court Rules of Practice and Procedure, and all section references are to the Internal Revenue Code of 1986, as amended and in effect for the year at issue. All dollar amounts have been rounded to the nearest dollar.

[2]The notice of deficiency also determined that petitioners are liable for a sec. 6662(a) accuracy-related penalty attributable to negligence, see sec. 6662(b)(1), or (continued...)

Initial trial proceedings were conducted in this case on December 9, 2014, in New York, New York, followed by additional trial proceedings at a special trial session on August 2 and 3, 2017, in Washington D.C.[3] Since that time, there have been significant developments in the case law concerning the application of section 6751(b)(1),[4] culminating with the issuance of the Court's opinion in Graev v. Commissioner (Graev III), 149 T.C. __ (Dec. 20, 2017), supplementing and overruling in part, 147 T.C. 460 (2016). Graev III sets forth the history of our interpretation of section 6751(b)(1). Suffice it to say that, after having earlier taken a contrary position, in Graev III we held that the Commissioner's burden of production under section 7491(c)[5] includes establishing compliance with the written supervisory approval requirement of section 6751(b)(1).

The evidence respondent proffers consists of the Second Amended Declaration of Firdosa Khatib (declaration), revenue agent (RA Khatib), and a

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[2](...continued)
a substantial valuation overstatement, see sec. 6662(b)(3). On brief respondent did not argue for the applicability of the substantial valuation penalty and has therefore abandoned that argument. Mendes v. Commissioner, 121 T.C. 308, 312-313 (2003). While respondent has previously argued for the applicability of the negligence penalty, he has been unable to locate any evidence of his compliance with sec. 6751(b)(1) with respect to that ground and now concedes the issue.

[3]At the conclusion of the December 9, 2014, trial proceedings, the Court held the record open for the possible submission of stipulations covering certain matters and the admissibility of a disputed exhibit. The record was closed on February 20, 2015, and briefing was completed on June 22, 2015. At the conclusion of the special trial session on August 2 and 3, 2017, the record was closed. Supplemental briefing was completed on February 12, 2018.

[4]Sec. 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."

[5]Under sec. 7491(c), the Commissioner bears the burden of production with respect to accuracy-related penalties and must come forward with sufficient evidence indicating that it is appropriate to impose them. See Higbee v. Commissioner, 116 T.C. 438, 446-447 (2001).

document attached thereto, marked by respondent as Exhibit A. The document marked as Exhibit A is titled "Civil Penalty Approval Form" (penalty approval form). Respondent argues that the proffered evidence establishes that he satisfied the requirements of section 6751(b)(1) in determining that petitioners are liable for the substantial understatement penalty for 2007. Specifically, respondent argues that the evidence establishes that RA Khatib initially determined the applicability of the substantial understatement penalty and prepared the penalty approval form, and that her immediate supervisor, Dana Rosario, group manager (GM Rosario), thereafter approved (in writing) the assertion of the penalty. Respondent argues that the proffered evidence is admissible pursuant to Rules 803(6) and 902(11) of the Federal Rules of Evidence, which together provide for the self-authentication of records kept in the course of a regularly conducted activity of an organization.[6]

As noted above, petitioners oppose respondent's motion. Petitioners argue that: (1) respondent's motion does not satisfy the necessary standard for reopening the record; (2) the "proffered evidence is confusing, ambiguous, and does not satisfy Respondent's burden of proof under § 6751(b)"; and (3) respondent's "inexcusable" lack of diligence in raising the supervisory approval issue and submitting the proffered evidence prejudices petitioners because they have been deprived of the opportunity to test the proffered evidence and cross-examine RA Khatib and GM Rosario.

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[6]The declaration provides that in the normal course of her duties, RA Khatib: (1) performed the examination of petitioners' 2007 Form 1040, U.S. Federal Income Tax Return and proposed the assertion of the sec. 6662 penalty for a substantial understatement of income tax; and (2) prepared, in accordance with sec. 6751(b) and consistent with her regular practice, the penalty approval form, and requested the approval of her immediate supervisor, GM Rosario, which GM Rosario subsequently granted by executing the penalty approval form. RA Khatib declares that the penalty approval form was made at or near the time of the occurrence of the matters set forth therein. She also declares that she has personal knowledge of the recordkeeping system of the Internal Revenue Service (IRS), and that the penalty approval form was taken from petitioners' administrative file. She declares that the penalty approval form was kept in the course of the IRS's regularly conducted activity, and that it is the IRS's regular practice to keep such records.

Discussion

Whether to reopen the record for the submission of additional evidence is a matter addressed to the sound discretion of the Court. See Zenith Radio Corp. v. Hazeltine Research, Inc., 401 U.S. 321, 331-332 (1971); Rodman v. Commissioner, 542 F.2d 845, 859-860 (2d Cir. 1976), aff'g in part, rev'g in part and remanding T.C. Memo. 1973-277; Dynamo Holdings Ltd. P'ship v. Commissioner, 150 T.C. __, __ (slip op. at 10) (May 7, 2018); Butler v. Commissioner, 114 T.C. 276, 286-287 (2000). We will grant a motion to reopen the record only if the evidence relied on is (1) not merely cumulative or impeaching, (2) material to the issues involved, and (3) likely to change some aspect of the outcome of the case. See Butler v. Commissioner, 114 T.C. at 287; Fiedziuszko v. Commissioner, T.C. Memo. 2018-75; Azam v. Commissioner, T.C. Memo. 2018-72; Sarvak v. Commissioner, T.C. Memo. 2018-68.

The evidence proffered by respondent is neither cumulative nor impeaching. The record includes no evidence as to whether respondent obtained the requisite supervisory approval of the initial penalty determination. In the absence of such evidence, respondent cannot meet his burden of production concerning the accuracy-related penalty. Thus, the proffered evidence is material.

That leaves the question whether the proffered evidence, if admitted, is likely to change the outcome of this case. Petitioners, describing the proffered evidence as "confusing and ambiguous", argue that, if admitted, it is unlikely to have the required impact due to "stark ambiguities and inconsistencies present in the Penalty Form." They therefore argue that respondent has failed to meet the threshold test for reopening the record.

Petitioners principally allege three ambiguities in the penalty approval form.[7] First, petitioners note that under a column on the penalty approval form labeled

[7]Petitioners also contend that the penalty approval form does not comply with an Internal Revenue Manual (IRM) provision cited on the form. (Petitioners then discuss the terms of IRM pt. 4.10.6.7.1 (May 14, 1999) and IRM pt. 4.10.6.7(2) (May 14, 1999) when in fact the form cites IRM pt. 4.10.6.7(1) (May 14, 1999).) Notwithstanding this error, the larger point petitioners appear to be making is that the explanation for the penalty position taken on the form is inadequate. As discussed more fully infra p. 6, we will defer resolving the proper interpretation of the form until petitioners have been afforded an opportunity for

(continued...)

"Assert Penalty", there are two boxes, respectively labeled "Yes" and "No", which may be checked for each penalty listed on the form. Petitioners note that, with respect to the substantial understatement penalty asserted by respondent, both the "Yes" and "No" boxes are checked.

Second, petitioners note that within a box on the penalty approval form labeled "Reason(s) for Non-Assertions of Penalty(s)", someone, ostensibly RA Khatib, has typed, "The agent as [sic] considered and applied substantial understatement penalty per Section 6662." Petitioners note that a box underneath the aforementioned non-assertion box, labeled "Reasons for Assertions of Penalty(s)", is blank.

Third, petitioners note that the signature block provided on the penalty approval form for the supervisory approval of any initially determined penalty is labeled "Group Manager Approval to Assess Penalties Identified Above * * * (And for non-assertion of Substantial Understatement Penalty where dollar criteria for penalty has been met)".

Petitioners argue that in view of the ambiguities they allege, "it is unclear whether the supervisor was approving the assertion of a penalty or the non-assertion of a penalty where the dollar criteria had been met." In our view, the ambiguities petitioners cite raise issues concerning the proper interpretation or construction of the penalty approval form. Those ambiguities might reasonably be interpreted as either substantial defects negating a finding of written supervisory approval, or instead ministerial errors attributable to carelessness in the preparation of the form. For example, while it is true that both the "Yes" and "No" boxes are checked for the substantial understatement penalty, the "No" box is checked for all

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[7](…continued)
additional discovery. We note, however, that the adequacy of any explanation for the assertion of the penalty for a substantial understatement of income tax under sec. 6662(b)(2) would presumably take into account the mechanical nature of that penalty, premised as it is upon meeting thresholds tied to the magnitude of the understatement in relation to the tax required to be shown on the return and the absolute size of the understatement. When these thresholds are satisfied, the applicability of the penalty is self-evident. See sec. 6662(d)(1)(A). Moreover, the IRM does not have "the force or effect of law." Vallone v. Commissioner, 88 T.C. 794, 807 (1987).

18 penalties listed on the form. Yet, the substantial understatement penalty is the only penalty for which the "Yes" box is checked.

We conclude it would be premature to decide the proper interpretation to be given the penalty approval form without affording petitioners the opportunity for additional discovery. However, if the ambiguities were to be resolved in respondent's favor, the penalty approval form would appear to establish that written supervisory approval was obtained for the assertion of an accuracy-related penalty for a substantial understatement of income tax for 2007. Therefore, the proffered evidence, if admitted (with the ambiguities resolved in respondent's favor), is likely change the outcome of this case. Accordingly, respondent has met the threshold test for reopening the record, and we must balance the equities.

Appeal in this case (absent a stipulation to the contrary) is to the Court of Appeals for the Second Circuit. In that venue, the following factors are considered when determining whether to reopen the trial record: (1) the diligence (or lack thereof) of the moving party in submitting the evidence; (2) the possibility of prejudice to the nonmoving party if the record were reopened; and (3) where the interests of justice lie. See John v. Sotheby's Inc., 858 F. Supp. 1283, 1288 (S.D.N.Y. 1994), aff'd, 52 F.3d 312 (2d Cir. 1995); see also Dynamo Holdings Ltd. P'ship v. Commissioner, slip op. at 10-11.

We conclude that the interests of justice are best served by reopening the record in this case. First, "[a] change in legal standards is a proper ground for reopening proof." In re Chattanooga Wholesale Antiques, Inc., 930 F.2d 458, 465 (6th Cir. 1991); see also Sequa Corp. v. GBJ Corp., 156 F.3d 136, 144 (2d Cir. 1998) (abuse of discretion where trial court denied motion to reopen after adopting a post-trial legal theory "advocated and anticipated by neither party" and for "which no evidence had been introduced"). As noted supra p. 2, our holding in Graev III--that the Commissioner must, as part of his burden of production under section 7491(c), establish that written supervisory approval was obtained under section 6751(b)(1) for the assertion of accuracy-related penalties at issue--was a reversal of our previous holding that supervisory approval could, in effect, be obtained at any point before assessment. The record in this case was closed at the time Graev III was issued. We think that, under the circumstances, respondent is entitled to a fair opportunity to submit evidence of his compliance with section 6751(b)(1) in determining the accuracy-related penalty in this case.

Second, neither party raised compliance with section 6751(b)(1) as an issue in the pleadings, during the two trial settings, or in their opening or answering

briefs. Indeed, petitioners raised their alleged infirmities in the penalty approval form only after respondent moved to reopen the record to proffer the penalty approval form. Although petitioners argue that respondent has shown an "inexcusable" lack of diligence in proffering the penalty approval form at this time, respondent advises the Court in his Response that petitioners' counsel has had a copy of the penalty approval form since on or about June 17, 2014--nearly six months before the original trial in this case. We must question why, if the penalty approval form is so riddled with "stark ambiguities and inconsistencies", petitioners failed to raise such arguments earlier. Under the circumstances, we do not find a fatal lack of diligence on respondent's part. See Fiedziuszko v. Commissioner, T.C. Memo. 2018-75, *26.

Finally, the nature of the proffered evidence weighs in favor of reopening the record. In addition to being material, the proffered evidence appears to be admissible pursuant to the hearsay exception for records kept in the course of a regularly conducted activity of an organization. See Rules 803(6) and 902(11), Fed. R. Evid.[8]

[8]We note that the penalty approval form might also constitute a "verbal act", i.e., a category of statements excluded from hearsay because "the statement itself affects the legal rights of the parties or is a circumstance bearing on conduct affecting their rights." Fed. R. Evid. 801(c) advisory committee's note ("If 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."); see also Robertson v. U.S. Bank, N.A., 831 F.3d 757, 764 (6th Cir. 2016); United States v. Bowles, 751 F.3d 35, 39-40 (1st Cir. 2014); Mueller v. Abdnor, 972 F.2d 931, 937 (8th Cir. 1992); United States v. Aikins, 946 F.2d 608, 614-615 (9th Cir. 1990). We additionally note that the penalty approval form, if offered with the proper certification, might be admissible as a self-authenticating public record. See Rule 803(8) (exempting records of public agencies, when properly certified, from hearsay), Rule 902 (properly certified public records deemed self-authenticating), Fed. R. Evid.; see also United States v. Dickert, 635 F. App'x 844, 849-850 (11th Cir. 2016) (no abuse of discretion where district court admitted Internal Revenue Service Form 4340 as self-authenticating public record); Hughes v. United States, 953 F.2d 531, 539-540 (9th Cir. 1992) (same).

While we will reopen the record, we will exclude the declaration and penalty approval form without prejudice in order to ensure petitioners are accorded the notice to which they are entitled. See 902(11), Fed. R. Evid. In addition, in order to eliminate any possible prejudice to petitioners from reopening the record for possible receipt of the evidence respondent has proffered, and to accord petitioners any rights to which they would have been entitled if respondent had sought to introduce the declaration and penalty approval form at trial, see Estate of Freedman v. Commissioner, T.C. Memo. 2007-61, 93 T.C.M. (CCH) 1007, 1013 (2007); Megibow v. Commissioner, T.C. Memo. 2004-41, 87 T.C.M. (CCH) 987, 991 (2004), we will allow discovery regarding the declaration and penalty approval form, as set forth below, and thereafter consider whether supplemental trial proceedings are necessary.

The foregoing considered, it is

ORDERED that respondent's First Amended Motion to Reopen the Record is granted in part and denied in part. It is further

ORDERED 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 Second Amended Declaration of Firdosa Khatib and Exhibit A attached thereto are excluded from the record without prejudice. It is further

ORDERED that the parties shall have until October 9, 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. Such discovery shall be limited to the issue of respondent's compliance with section 6751(b)(1) in determining the accuracy-related penalty in this case and may include matters authorized by Rules 70, 71, 72, and 74. It is further

ORDERED that on or before October 23, 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 with respect to respondent's compliance with section 6751(b)(1) in asserting the accuracy-related penalty in this case.

(Signed) Joseph H. Gale
Judge

Dated: Washington, D.C.
July 31, 2018