

DESCRIPTION OF LAW AND BILLS
RELATING TO
AWARDS OF ATTORNEY'S FEES IN TAX CASES
(Public Law 96-481, S. 752, and S. 1673)
SCHEDULED FOR A HEARING
BY THE
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INTERNAL REVENUE SERVICE
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INTRODUCTION

This pamphlet describes legislative proposals relating to the payment of attorneys' fees to taxpayers who prevail in tax litigation against the Government. It has been prepared by the staff of the Joint Committee on Taxation in connection with a public hearing on these proposals scheduled for October 19, 1981, by the Subcommittee on Oversight of the Internal Revenue Service of the Senate Committee on Finance.

The first part of this pamphlet describes present law provisions that allow awards of attorneys' fees, in certain circumstances, in tax cases: (1) the Civil Rights Attorney's Fees Awards Act of 1976 and (2) the Equal Access to Justice Act, which provides for such awards in certain tax cases in the Federal district courts and the United States Court of Claims (as of October 1, 1981). Part one of the pamphlet also includes a discussion of some of the relevant issues with respect to the awarding of attorneys' fees in tax cases. The second part of the pamphlet contains a description of two bills that would provide, exclusively, for the award of attorneys' fees in tax cases: S. 752 (introduced by Senators Baucus, Long, Goldwater, Williams, and Leahy) and S. 1673 (introduced by Senators Baucus, Grassley, Goldwater, Williams, and Leahy).

I. BACKGROUND

A. Present Law

The Civil Rights Attorney's Fees Awards Act of 1976

The Civil Rights Attorney's Fees Awards Act of 1976 (42 U.S.C. sec. 1988) provides, in part, that in any civil action or proceeding, brought by or on behalf of the United States, to enforce, or charging a violation of, a provision of the Internal Revenue Code, the court, in its discretion, may allow the prevailing party, other than the United States, reasonable attorney's fees as part of the costs. This provision has limited applicability to tax litigation and results in very few fee awards, because it is limited to actions brought by or on behalf of the Government (that is, to cases in which the taxpayer is the defendant). Most civil tax litigation is initiated by the taxpayer who brings suit against the Government. In the United States Tax Court, the taxpayer is the petitioner in a deficiency proceeding. In the Federal district courts and the U.S. Court of Claims, the taxpayer is the plaintiff suing the Government for a refund.

The Equal Access to Justice Act

Last year, as part of Public Law 96-481, the Congress enacted the Equal Access to Justice Act (28 U.S.C. sec. 2412) which, in part, authorizes awards to a prevailing party other than the United States of fees and other expenses incurred by that party in any civil action (other than cases sounding in tort) brought by or against the United States in any court having jurisdiction of that action, unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust. This provision applies, specifically, to cases in Federal district courts and the United States Court of Claims. However, the provision is not specifically applicable to cases in the United States Tax Court.¹

Because this provision applies to cases in which taxpayers are plaintiffs, and not merely to cases brought by the Government, it creates a greater potential for fee awards in tax cases than does the Civil Rights Attorney's Fees Awards Act of 1976. The provision became effective on October 1, 1981, and will continue to apply through final disposition of any action commenced before October 1, 1984.

Under the Equal Access to Justice Act, fees and other expenses that may be awarded to a prevailing party include the reasonable expenses of expert witnesses, the reasonable cost of any study, analysis, engineering report, test, or project which is found by the court to be necessary for the preparation of the party's case, and reasonable attorney's

¹ This is because the Equal Access to Justice Act is contained in Title 28 of the United States Code, which deals with courts created under Article III of the United States Constitution. The United States Tax Court was established under Article I of the United States Constitution.

fees. In general, no expert witness may be compensated at a rate that exceeds the highest rate of compensation for expert witnesses paid by the United States. Attorneys' fees in excess of \$75 per hour may not be awarded unless the court determines that a higher fee is justified. In general, parties who may recover fees and expenses under the Act are: (1) individuals whose net worth does not exceed \$1,000,000 at the time the action is filed; (2) sole owners of an unincorporated business, partnership, corporation, association, or organization whose net worth does not exceed \$5,000,000 at the time the civil action is filed (however, tax-exempt charitable organizations and certain cooperative associations are not subject to this net worth limitation); and (3) sole owners of an unincorporated business, partnership, corporation, association, or organization that has no more than 500 employees at the time the action is filed.

B. Issues

In General

Fee awards in tax cases.—The principal issue is whether taxpayers who prevail in civil tax actions should be entitled to awards for attorneys' fees. Proponents of fee awards in tax cases contend that these awards are necessary to deter abusive actions or overreaching by the Internal Revenue Service and to enable the individual taxpayer to vindicate his rights regardless of his economic circumstances. Opponents claim that fee awards in tax actions could seriously impair the administration of the tax laws. It is argued that the availability of fee awards would encourage taxpayers to litigate disputes rather than pursue administrative remedies, thereby increasing the already heavy volume of tax cases in the courts. An increase in tax litigation would generally impair the taxpayer's ability to obtain prompt resolution of a dispute. It is further argued that fee awards in tax cases are inappropriate because the taxpayer is generally not enforcing any rights beyond his own vested interest.

Specific Issues

If such awards are allowed, a number of related issues arise.

Courts having jurisdiction.—One issue is whether the provision for awards should apply in all courts having jurisdiction over tax issues. The Equal Access to Justice Act applies only to Federal district courts and the U.S. Court of Claims. Critics contend that the availability of fee awards in only these courts encourages forum shopping and makes an award depend upon the fact of whether the taxpayer paid the amount of tax at issue before suing the Government. Moreover, the majority of tax litigation occurs in the United States Tax Court. Thus, excluding the Tax Court from application of the provision would greatly restrict the payment of attorneys' fees in tax litigation generally.

Availability in administrative proceedings.—A further consideration is whether fee awards should be available in administrative proceedings. Proponents contend that unless fee awards are available at the administrative phase of a dispute between the Service and the taxpayer, taxpayers will be encouraged to bypass their administrative remedies and pursue litigation in order to obtain attorneys' fees. Critics of the availability of fee awards in administrative proceedings argue that they would add expense and complexity to the system of administrative appeals within the Internal Revenue Service which has been effective in resolving approximately 95 percent of disputes between the taxpayer and the Government without trial.

Types of tax controversies.—A related issue is the types of tax controversies or proceedings for which fee awards should be available.

It has been argued that awards should not be available in State court proceedings such as probate cases, State receiverships, assignments

for the benefit of creditors, or interpleaders where the action of the government is not discretionary. Also, it is further argued that certain declaratory judgment actions such as classification of organizations as tax-exempt, the qualification of certain retirement plans, and status of certain governmental obligations should be exempt from fee awards since, in these cases, the taxpayer is not seeking to vindicate his rights, but rather is hoping to qualify for a kind of favorable tax treatment not generally available to taxpayers without special characteristics. Others contend that the provision for fee awards can only be equitable and effective if it applies in all cases where the taxpayer opposes the Government, since the nature of the controversy, generally, does not affect the ability of the taxpayer to litigate against the Government.

Standards for award.—A significant issue in the award of attorneys' fees is the standards for determining if an award should be made. Some have argued that the court should have discretion to determine when an award is appropriate. Opponents of this standard argue that it still keeps the taxpayer at the mercy of the Government.

Others have argued that the prevailing party should be automatically entitled to an award of fees. Opponents of this standard contend that it is often difficult to determine who the prevailing party is in tax litigation, since a number of unrelated factual issues and taxable years may be involved in a case. Moreover, the Government should not necessarily be penalized for the reasonable pursuit of debatable tax issues. Tax administration would be ineffective if the Government conceded all close cases to the taxpayer in order to avoid payment of fee awards.

A third standard also has been advocated under which the prevailing party must show that the action of the Government in pursuing litigation was unreasonable. Proponents of this standard contend that this would protect the taxpayer from Government abuses and encourage responsible Government action while, at the same time, avoid the potential for a massive increase in the burden of the courts. Opponents of this standard claim that taxpayers would rarely recover because the evidence of unreasonable conduct is usually in the possession of the Government. Moreover, the taxpayer already has the burden of proving either that he is entitled to a refund or not liable for a certain amount of taxes in order to prevail in the case.

Finally, some urge that, in accordance with the standards applied under the Equal Access to Justice Act, taxpayers who prevail in tax cases should be entitled to an award of attorneys' fees unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust.

Eligible recipients.—There is a further issue of what taxpayers should be eligible for fee awards. The Equal Access to Justice Act places income and size limitations on recipients. Proponents of these types of limitations argue that fee awards are intended to enable those taxpayers who would not otherwise be able to afford to defend their interests to litigate. It is contended that more affluent taxpayers who were awarded fees would be receiving a windfall. Opponents of these limitations contend that the taxpayer's wealth or company size should not affect the determination of whether an award is appropriate. Some advocates have proposed that the Government also be eligible for fee awards. It is argued that this would deter frivolous taxpayer suits.

Opponents contend, however, that permitting the Government to recover fees would chill all taxpayer suits including meritorious ones.

Another suggested prerequisite to eligibility for attorneys' fee awards is a requirement that taxpayers exhaust all administrative remedies prior to litigation. Proponents argue that failure to impose such a requirement would encourage taxpayers to bypass the administrative appeals process, which is one of the principal forums for the resolution of tax disputes, and would substantially increase the amount of tax litigation. Opponents of such a requirement contend that it would be burdensome to enforce. Furthermore, they feel that, in many cases, it is futile for a taxpayer to pursue administrative remedies. Others have suggested that, in order to preserve the role of pretrial administrative procedures, an award of attorneys' fees should not be allowed if the taxpayer's own failure to cooperate in a reasonable administrative investigation leaves the Government with no alternative but to litigate the tax liability.

Nature and extent of costs.—The nature and extent of costs to be recovered also should be considered. Costs of litigation may include not only attorneys' fees and court costs but also accountants' fees, expenses of expert witnesses, or the costs of studies, lab tests, engineering reports necessary for the preparation of a case, travel, clerical assistance, preparation of documents, and other related expenses. Some have argued that all of these costs should be explicitly included in any fee award provision. Others have argued that an award of these expenses may not be appropriate or reasonable in every case. They urge that the court have discretion to determine reasonable attorneys' fees and costs.

It also has been argued that the overall amount of money should be limited. Proponents of a dollar limit claim that the most complex and sophisticated tax issues and, thus, the most costly are generally raised by more affluent individuals and corporations. In addition, a dollar limit might encourage early settlements in docketed cases. Therefore, in order to discourage excessive litigation and yet assure relief to taxpayers with limited resources, it is argued that a ceiling on the amount of the award is appropriate. Critics of a ceiling argue that the wealth of the taxpayer should not affect the determination of whether a taxpayer should be reimbursed for the costs of litigation. They urge that the determination be based on an evaluation of the facts of each case, rather than the characteristics of the taxpayer.

Temporary or permanent provision.—A final issue to be considered is whether a provision authorizing the award of attorneys' fees in tax cases should be permanent. Since fee awards do constitute a departure from the usual procedure in the American judicial system where, generally, litigants bear their own costs, some have urged that attorney's fee legislation expire after a number of years. Proponents of a sunset provision argue that it would afford administrators, legislators, and practitioners an opportunity to assess the effects of the legislation. The Equal Access to Justice Act, itself, has a sunset date of October 1, 1984. Opponents of a sunset provision argue that permanent fee award legislation is necessary to deter abusive Government action and enable taxpayers to defend their interests. Moreover, critics contend that it could create difficult transitional problems for cases pending on the sunset date.

II. DESCRIPTION OF BILLS

S. 752 (Senator Baucus, *et al.*) and
S. 1673 (Senators Baucus, Grassley, *et al.*)

Taxpayer Protection and Reimbursement Act

Explanation of Provisions

In general

The bills would provide for the award of reasonable court costs to prevailing parties in civil tax actions. Specifically, court costs could be awarded in civil actions or proceedings brought by or against the United States in any United States court, including the Tax Court, for the determination, collection, or refund of any tax, interest, or penalty. Thus, parties who are plaintiffs or defendants in suits involving the determination, collection, or refund of any tax, interest, or penalty imposed by the Internal Revenue Code would be eligible for these awards. However, no award could be made to the United States or to a creditor of the taxpayer.

The bills are identical except, as noted below, with respect to the maximum amount of court costs that could be awarded.¹

Limitations

The amount of reasonable court costs would be limited to a maximum of \$20,000 by S. 752. Under S. 1673, maximum court costs would be \$25,000. Under both bills, awards would be allowed only to the extent that costs were allocable to the United States and not to any other party to the action or proceeding.

Reasonable court costs

Under the bills, reasonable court costs would include (1) the reasonable expenses of expert witnesses, (2) the reasonable cost of any study, analysis, engineering report, test, or project that is found by the court to be necessary for the preparation of the party's case, and (3) reasonable fees paid or incurred for the services of attorneys. In the case of Tax Court proceedings, fees for the services of an individual (whether or not an attorney) who is authorized to practice before the Tax Court would be treated as fees for the services of an attorney.

Prevailing party

The bills provide guidelines for determining who is a prevailing party, for purposes of awarding court costs. A prevailing party would be a party (other than the United States or a creditor of the taxpayer involved) who (1) establishes that the position of the United States in the civil action or proceeding was unreasonable, and (2) has sub-

¹ A hearing was held on a similar bill (H.R. 3262) on September 28, 1981, by the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means.

stantially prevailed with respect to the amount in controversy or has substantially prevailed with respect to the most significant issue, or set of issues, presented.

The determination of who is a prevailing party would be made either by the court or by agreement of the parties.

Excluded actions

The bills would exclude certain civil actions and proceedings from those eligible for awards. The excluded actions would be:

(1) Declaratory judgments with respect to the status and classification of organizations as tax-exempt organizations, qualified charitable donees, private foundations, or private operating foundations (unless the action or proceeding involves the revocation of the tax-exempt status of a charitable organization);

(2) Declaratory judgments with respect to the initial or continuing qualification of certain retirement plans;

(3) Declaratory judgments with respect to whether a transfer of property from a United States person to a foreign corporation has the avoidance of Federal income taxes as one of its principal purposes; and

(4) Declaratory judgments with respect to the status of certain governmental obligations for purposes of the income tax exclusion for interest under Code section 103(a).

The bills would make their new Code provision for awards of court costs the exclusive provision for such awards in any tax cases to which this new provision applies. Thus, taxpayers would have to seek such awards for costs in tax litigation under new Code section 7430 and would be denied awards under the Equal Access to Justice Act and the Civil Rights Attorney's Fees Awards Act of 1976.

Multiple actions

The bills would require that multiple actions which could have been joined or consolidated, and a case or cases involving a return or returns of the same taxpayer (including a married couple's joint returns) which could have been joined in a single proceeding in the same court, generally must be treated as a single action or proceeding, whether or not joined or consolidated for purposes of awarding court costs. However, if the court determines that it would be inappropriate to treat such cases as joined or consolidated, for purposes of awarding court costs, awards may be determined for the cases separately.

Right of appeal

An order granting or denying an award would be incorporated as part of the court's decision or judgment. The order would be appealable in the same manner, and to the same extent, as the decision or judgment.

Source of awards

Payments of awards would be made from the funds of the Government agency involved in the action or proceeding.

Effective Date

The bills would apply to civil actions and proceedings filed after December 31, 1980, and before January 1, 1991.