DESIGNATING CASES FOR LITIGATION

Comments by
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Chief Judge Wells, Judges and Senior Judges of the Court, Special Trial Judges, those soon-to-be invested as judges, and fellow conferees: many thanks for the opportunity to address this Conference. I have been privileged to attend Tax Court Judicial Conferences since 1985 and have always valued these gatherings as important occasions for the Court to join with members of the bar who know it best. While the opportunity to effect justice from the bench is incomparable, the major disadvantage of being on the bench, in my view, is being isolated from the rough and tumble, give and take of practice as a member of the public or private bar. That disadvantage is mostly unavoidable, but I firmly believe that these conferences help to reduce that isolation. The Conferences give the Court an opportunity to construct an agenda helpful to it while hearing from those who know it best on issues that impact all of us.

I want to thank you for inviting 29 members of the Office of Chief Counsel to this conference. The dramatic increase in the number of Chief Counsel lawyers who can attend this conference serves to provide this conference with a broad base of Chief Counsel representatives, including, in addition to my Deputies, all of the principal Division Counsel and their Deputies, the Associate Chief Counsel for Procedure and Administration, the Assistant Chief Counsel who are involved in matters directly affecting the Court, many Area Counsel or Deputy Area Counsel, and several Special Trial Attorneys and Special Counsel.

Introduction of Topic

The principal topic that I want to address this morning is a matter that has caused some misunderstanding between my Office, the bar and the Court: that is the subject of designating cases for litigation and the significance of such designation.

I changed the procedures for designating cases almost immediately upon my arrival to the Office over a year ago to effect three goals: (1) the personal review and decision by the Chief Counsel on whether to designate a case for litigation, (2) an examination that fully develops a case prior to designation so that the case can proceed as expeditiously as possible to resolution in court, and (3) full disclosure to the taxpayer that a case was being considered for designation and an opportunity for the taxpayer to present reasons why the case should not be designated. I believe these changes were both necessary and important because of the significance I place on designating a case and because of my view of the proper role of litigation in tax administration.

Role of Litigation in Tax Policy

The mission of the Internal Revenue Service is to administer and enforce the tax law in a manner that is impartial and fair to all taxpayers. The fairest way to administer

the law in a system of self-assessment, such as ours, is to actually issue guidance to assist taxpayers in determining what works and what does not and to issue guidance that addresses the major issues as soon as possible so the public and Service personnel are aware of the positions of the agency. Through this process, the public can then rely on our announced positions and plan their affairs accordingly. Service personnel can also rely on this guidance and not burden taxpayers with issues that are not sustainable or spend resources unnecessarily. Published guidance serves these purposes even when taxpayers disagree with the published position because it helps taxpayers and the Service focus their resources on genuine issues. In a system that depends on taxpayers' and their advisors' respecting the rules, it is important not to surprise them with retroactive rules. I'm reserving on that interesting but complicated topic for another day, and for now, I'd like to suggest that using litigation as a tax policy tool to shape the law achieves, in my view, about the most retroactive rule making possible. That is not to say that there are not important legal disputes that can only be resolved by a court. What it does mean is that, to be impartial and fair in our administration of the tax laws, it is imperative that Treasury and the Service do not try to stretch our interpretations of the law to achieve a result that the statute and regulations do not permit or to deny the benefits under the statute where it plainly allows them. If we want tax advisors to respect the rules, we need to lead by example.

Litigation, as you are well aware, tends to focus on very narrow, fact intensive issues, and courts should resolve cases in the narrowest way. A court's perspective is, by definition, limited to the record before it, so it is highly inappropriate for government officials charged with administering the tax laws to try to establish new rules through court decisions. Aside from the years of delay that leave taxpayers and the Service uncertain of what actions comply with the law, the court's formulation of a rule, no matter how well crafted, cannot possibly reflect the perspective of administering a tax system that touches the lives of nearly every American and reaches into the middle of most business decisions. Many tax administration concerns are implicated when broad rules are formulated — resource limitations, other programmatic initiatives, the interplay with other rules, budgetary limitations, to mention a few — that cannot possibly be accounted for or explained in the narrow context of a single case.

Litigation, properly utilized, has an important role in tax administration, namely, enforcement of the law. Bona fide disputes will always exist between taxpayers and the Service over the proper interpretation of the tax law and the application of that law to complex facts. Taxpayers can and should legitimately challenge positions that the Service takes in published guidance, but while the Service resolves most of these tax disputes by settlement, even before a petition in this Court is filed, and resolves most of the cases pending before this Court by settlement, there are some matters that cannot be settled.

Designation for Litigation

As a former colleague, I share your belief that the Court's role in tax

administration is considerably broader than merely providing a means for the parties to resolve tax disputes between them. The Court's nation-wide jurisdiction elevates its decisions in interpreting the tax law beyond mere case resolution. It is this unique and Congressionally-mandated role of the Court that makes the Chief Counsel's designation of cases for litigation significant. The Court exercises this responsibility affirmatively on behalf of taxpayers in those cases where the Court perceives that the Commissioner's concession of an issue could, in effect, deprive the taxpayer of a decision that would collaterally estop future disputes. Perhaps, the most important expression of this responsibility was the Court's landmark opinion in *McGowan v. Commissioner*, 67 T.C. 599 (1976), in which the Court made two points: (1) the Court's role as a viable, independent arbiter of Federal tax disputes would be undermined if it were required to simply accept respondent's concession [67 T.C. at 607], and (2) the Court believed that the uncertain future created by the absence of a decision would show a "careless and callous disregard" for the rights of affected individuals who sought and were entitled to a definitive answer.

The Service fully accepts and agrees with *McGowan* and its progeny, particularly for issues needing precedential resolution. It is this same, responsible approach to case resolution that forms the basis for designating cases for litigation. As tax administrators, the Commissioner and the Chief Counsel are responsible to the public beyond merely resolving docketed cases on an expeditious basis. Like the Court, our principal interest is to ensure similar treatment of similarly situated taxpayers and to achieve the answer the statute intends. This presupposes our ability to pursue enforcement initiatives, particularly where we believe taxpayers, most of who will not be before the Court, are applying the tax law in a way not permitted by the statute and regulations. If the Service is to perform its public duty, the Commissioner needs a mechanism to follow through on the Chief Counsel's legal advice on how issues should be resolved. Not infrequently effective and fair tax administration demands enforcement, and often enforcement means litigating to finality.

I would like to reiterate our commitment to settlement of cases as appropriate. We share the Court's goal of efficient disposition as reflected in the Standing Pre-Trial Orders. If it were ever unclear, and I know the Court has, unfortunately, had to address this point, designating a case for litigation in no way conflicts with the Court's rules or expected practices, including informal discovery. We certainly will follow the Court's direction to begin discussions, as soon as practicable, for purposes of settlement. We fully agree with the observation in these orders that valuation cases, reasonable compensation cases, and minor issues generally are and should be susceptible of settlement. We continue to be committed to the proposition that the parties must negotiate in good faith, and the Court knows that we settle far more cases than we try. Even in the ones we cannot fully settle, we work hard and actively to narrow the issues that are presented to the Court for disposition, whether by trial or summary judgment.

Notwithstanding our commitment to settle as many cases and issues as appropriate, some cases present recurring, significant legal disputes affecting large

numbers of taxpayers, and the public deserves a definitive, precedential answer from the courts. The designation procedure addresses those situations. If I designate a case, or an issue in a case, for litigation whether in docketed or non-docketed status, the case or issue will not be settled (other than through a complete concession by the taxpayer) without my personal review and removal of the designation. Some form of this procedure has been known to the public through our Chief Counsel Notices, our Directives Manual, and other publications, for at least 20 years.

The designation procedure is not a mere formality or a rubber stamp of cases recommended for litigation. Emphatically, I do not designate a case solely because our legal position is strong or the facts indicate that the litigation hazards are insignificant. Far from being routine, this procedure requires the highest levels of the Service and Counsel to consider the effect of the case on our administration of the tax laws nation-wide. Because of the importance of the designation procedure, and its impact on the Service and the Court, the sole authority to approve a request to designate a case, or an issue in a case, for litigation resides personally with the Chief Counsel. I exercise that authority only after extensive deliberations and consideration of recommendations from the Division Counsel and the Associate Chief Counsel with jurisdiction over the subject matter of the case, as well as the recommendations and concurrence of the Chief of Appeals, and the appropriate Division Commissioner. The taxpayer and its representatives also have the opportunity to discuss with me personally why the issue or the case is not an appropriate vehicle for designation before I act on the recommendation.

To approve a designation, I must be convinced that a recurring legal issue is presented on which there is a critical need for enforcement beyond the immediate case or taxpayer. For these same policy reasons, in addition to our reluctance to subject legal issues (as opposed to factual issues) to arbitration, a case designated for litigation is not an appropriate subject of mediation or voluntary binding arbitration. The ultimate goals of the designation procedure are to reduce litigation costs and to conserve resources of both the Service and the public to obtain precedential resolution of a recurring legal issue. Accordingly, I will not approve a designation request unless I am persuaded that these goals will be furthered. Consistent with this approach, I will not approve a request to designate a factual issue for litigation, such as valuation, because factual issues are mostly case specific and will not achieve the goals of the designation program.

In my view, our policy goals in designating a case, or an issue in a case, for litigation are consistent with *McGowan*. Moreover, there is no room in the designation procedure for failing to follow the Court's Rules of Practice & Procedure, its Standing Pre-Trial Orders, or any other court directive other than to settle the case (which would not be an appropriate order). When I have made a decision to designate a case or an issue in a case for litigation, I have exercised my judgment in good faith, as the Commissioner's principal legal officer, in determining that the issue in the case involved is not susceptible of routine settlement consistent with the objectives of tax administration.

Nonetheless, even after I have designated a case or an issue in a case for litigation, Chief Counsel lawyers remain willing to consider the settlement potential and litigation hazards presented by the case, particularly as the parties narrow and refine the issues during trial preparation, and they certainly should reconsider the settlement potential if the law changes. If, during trial preparation, discovery and consultation between the parties, a designation should be reconsidered, the procedures for de-designation of a case should be implemented. The determination to de-designate a case, like the original designation determination, is reserved to me as Chief Counsel. The fact that de-designation is available in appropriate cases confirms our commitment to engage in good faith negotiations in every case, consistent with the Court's mandate, including cases designated for litigation. Nevertheless, with the level of deliberation brought to bear on a designation, I would expect that de-designations would be rare.

Conclusion

With the nationwide tax jurisdiction of the Court and the fewer cases that the Commissioner is pursuing to litigation generally, I believe that the Court should welcome the designation procedure. Properly implemented, the procedure does not in any way derogate the rules or practice of the Court and offers a formal expression of the Service's views of the importance of the case to tax administration. Please be assured that I will personally be involved in the proper implementation of the procedure.

Many thanks, again, for the hospitality of the Court.