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# EXAMINING UNREASONABLE IRS BEHAVIOR AND THE AWARD OF ATTORNEY'S FEES IN TAX CASES: UNDERLYING ACTION v. LITIGATION POSITION



## I. INTRODUCTION

In 1982, Congress enacted section 7430 of the Internal Revenue Code as part of the Tax Equity and Fiscal Responsibility Act (TEFRA).[1] Section 7430 provides an award of attorney's fees and reasonable litigation costs to prevailing tax litigants who encounter unreasonable conduct by the Internal Revenue Service (IRS).[2] The provision attempts to deter abusive conduct and overreaching by the IRS.[3] Section 7430 addresses difficulties in prior legislative attempts to compensate taxpayers confronting nonmeritorious government claims.[4]

A troublesome dichotomy remains over whether the provision's language encompasses the IRS's pre-litigation conduct or only its actual litigation pos-

1. Tax Equity and Fiscal Responsibility Act, Pub. L. No. 97-248, 96 Stat. 324, 572 (1982) (codified at 26 U.S.C. § 7430 (1982)).

2. I.R.C. § 7430(a), (c) (West Supp. 1985).

3. H.R. REP. No. 404, 97th Cong., 1st Sess. 11 (1982).

4. STAFF OF JOINT COMM. ON TAXATION, 97TH CONG., 2D SESS., DESCRIPTION OF LAW AND BILLS RELATING TO AWARDS OF ATTORNEY'S FEES IN TAX CASES 5 (1981).



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ture.[5] Congress failed to prescribe the "position" courts must examine for a finding of unreasonableness.[6] Some courts award fees only for unreasonable IRS litigation behavior;[7] others provide compensation whenever unreasonable government action forces a private party into court.[8] Unreasonable IRS conduct during the administrative stages of a proceeding should trigger section 7430's award of litigation costs to compensate victimized taxpayers.

This Note will examine both legal and pragmatic ramifications of the Code's provision for fee-shifting in tax litigation. The history of cost awards and the mechanical requirements of section 7430 will be considered. Various federal court positions and the underlying policy considerations for them will be examined. Finally, this Note will advocate adoption of the "underlying action" theory for the award of reasonable litigation costs in suits with the IRS.

## II. Historical Background of the Award of Attorney's Fees

### A. *American Rule*

Prior to TEFRA, a taxpayer's legal basis for obtaining awards of attorney's fees and litigation costs was tenuous. Under the common law "American Rule," litigants assumed the financial obligations of their lawsuits.[9] The doctrine of sovereign immunity further protected the government from awards of fees and costs to prevailing taxpayers.[10] Federal courts exercised equitable power to award costs in two limited situations: when an opposing party acted in bad faith,

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5. *See infra* notes 71-147 and accompanying text.

6. *See infra* notes 74-75 and accompanying text.

7. *See infra* notes 110-47 and accompanying text.

8. *See infra* notes 71-109 and accompanying text.

9. The American Rule was first articulated by the Supreme Court in Arcambel v. Wiseman, 3 U.S. (3 Dall.) 306 (1796). In *Arcambel*, the Court denied attorney's fees to the prevailing party on the premise that "[t]he general practice of the United States is in opposition to it; and even if that practice were not strictly correct in principle, it is entitled to the respect of the court, till it is changed, or modified, by statute." 3 U.S. (3 Dall.) at 306.

The principle theory behind the Rule dictates that the poor should not be deterred from litigating by the possibility of liability for their opponents' attorney's fees. *See* Fleischmann Distilling Corp. v. Maier Brewing Co., 386 U.S. 714, 717-18 (1967); Robertson & Fowler, *Recovering Attorneys' Fees from the Government Under the Equal Access to Justice Act*, 56 Tul. L. Rev. 903, 909 (1982) (poor should not be discouraged from participating in litigation).

Despite criticism, the American Rule has generally withstood the test of time. *See, e.g.*, Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240 (1975); F.D. Rich Co. v. United States, 417 U.S. 116 (1974); Fleischmann Distilling Corp. v. Maier Brewing Co., 386 U.S. 714 (1967).

*See generally* Falcon, *Award of Attorneys' Fees in Civil Rights and Constitutional Litigation*, 33 Md. L. Rev. 379, 379-419 (1973) (justifications and criticisms of American Rule); Comment, *Court Awarded Attorney's Fees and Equal Access to the Courts*, 122 U. Pa. L. Rev. 636 (1974) (detailed discussion of American Rule).

10. *See* Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 267-68 n.42 (1975) ("a sovereign is not liable for costs unless specific provision for such liability is made by law" (quoting the Reviser to 28 U.S.C. § 2412(a) (1946)); Sharon v. Commissioner, 66 T.C. 515, *aff'd*, 78-2 U.S. Tax Cas. (CCH) ¶ 9834, *cert. denied*, 442 U.S. 941 (1979). *See generally* Cohen, *Awards of Attorneys' Fees Against the United States: The Sovereign Is Still Somewhat Immune*, 2 W. New Eng. L. Rev. 177, 181-82 (1979) (discussing the sovereign immunity defense to attorney's fees liability).

vexatiously, or for oppressive reasons;[11] and when a prevailing litigant conferred a common benefit on an ascertainable group of persons.[12] In addition, prior to 1975, the "private attorney general" theory provided fee awards when a suit ultimately vindicated important societal rights.[13] In *Alyeska Pipeline Service Co. v. Wilderness Society*,[14] the Supreme Court abridged the law of fee-shifting. The Court eliminated the private attorney general doctrine and confined awards, absent express statutory[15] or contractual authorization, to the original common law exceptions to the American Rule.[16]

### B. *Civil Rights Attorney's Fees Awards Act*

In 1976, Congress responded to *Alyeska* by passing the Civil Rights Attor-

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11. F.D. Rich Co. v. United States, 417 U.S. 116, 129 (1974); Lipsig v. National Student Mktg. Corp., 663 F.2d 178, 180 (D.C. Cir. 1980).

12. *See* Hall v. Cole, 412 U.S. 1, 5 (1973); Mills v. Electric Auto-Lite Co., 396 U.S. 375, 393-94 (1970); Jesser v. Mayfair Hotel, Inc., 360 S.W. 2d 652, 662-63 (Mo. 1962); *see also* Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 264-65 n.39 (1975) (exception limited to small and easily identifiable class of beneficiaries). *See generally* Note, *Awarding Attorney and Expert Witness Fees in Environmental Litigation*, 58 CORNELL L. REV. 1222, 1233-37 (1973) (common benefit exception is inapplicable to tax litigation with the IRS).

13. *See, e.g.*, Newman v. Piggie Park Enters., Inc., 390 U.S. 400, 402 (1968) (per curiam) (first articulation of private attorney general exception); Fairley v. Patterson, 493 F.2d 598, 604-06 (5th Cir. 1974) (reapportionment action pursuant to Voting Rights Act of 1965); Natural Resources Defense Council v. EPA, 484 F.2d 1331 (1st Cir. 1973) (private litigant's action against EPA to force compliance with Clean Air Amendments of 1970); Lee v. Southern Homes Sites Corp., 444 F.2d 143, 144 (5th Cir. 1971) (housing discrimination suit pursuant to 42 U.S.C. § 1982 (1970). *See generally* Dawson, *Lawyers and Involuntary Clients in Public Interest Litigation*, 88 HARV. L. REV. 849, 888-907 (1975) (discussing private attorney general case law); Comment, *supra* note 9, at 665-81 (discussing private attorney general exception); Note, *Awarding Attorneys' Fees to the "Private Attorney General;" Judicial Green Light to Private Litigation in the Public Interest*, 24 HASTINGS L.J. 733 (1973) (extensive discussion of theory).

14. 421 U.S. 240 (1975).

15. *See, e.g.*, Freedom of Information Act, 5 U.S.C. § 552(a)(4)(E) (1976); Privacy Act of 1974, 5 U.S.C. § 552a (g)(2)(B), (3)(B), (4); Federal Water Polution Control Act Amendments of 1972, 33 U.S.C. § 1365(d) (1976); Marine Protection, Research and Sanctuaries Act, 33 U.S.C. § 1415(g)(4); Noise Control Act of 1972, 42 U.S.C. § 4911(d) (1976); Clean Air Act, 42 U.S.C. § 7413(b) (Supp. I 1977). Congress authorized more exceptions after *Alyeska. See, e.g.*, Ethics in Government Act of 1978, 2 U.S.C. § 288(d) (Supp. II 1978); Civil Service Reform Act of 1978, 12 U.S.C. § 5596(b)(1)(A)(ii) (Supp. II 1978); Right to Financial Privacy Act of 1978, 12 U.S.C. § 3417(a)(4) (Supp. II 1978); Tax Reform Act of 1976, 26 U.S.C. § 6110(i)(2)(B) (1976); Surface Mining Control and Reclamation Act of 1977, 30 U.S.C. § 1270(d) (Supp. I 1977).

16. The Supreme Court rejected the District of Columbia Circuit's award of nonstatutory fees under the private attorney general doctrine, Wilderness Soc'y v. Morton, 495 F.2d 1026 (D.C. Cir. 1974), concluding:

> [C]ongressional utilization of the private-attorney-general concept can in no sense be construed as a grant of authority to the Judiciary to jettison the traditional rule against nonstatutory allowance to the prevailing party and to award attorneys' fees whenever the courts deem the public policy furthered by a particular statute important enough to warrant the award.

421 U.S. at 263. The court thus limited fee-shifting to the common fund and bad faith exceptions. 421 U.S. at 247-69; *see* Oakes, *Introduction: A Brief Glance at Attorneys' Fees After* Alyeska, 2 W. NEW ENG. L. REV. 169, 173 (1979).

ney's Fees Awards Act.[17] The Act gave courts discretionary authority to award fees to prevailing parties in civil tax suits involving enforcement of the Code.[18] Because the Act limited fee-shifting to tax litigation brought "by or on behalf" of the United States,[19] private tax plaintiffs still lacked an avenue for redress.[20] Courts frequently adopted the standards of bad faith, vexatiousness or harassment as prerequisites to recovery.[21] Few taxpayers, however, obtained fee awards.[22] The absence of a private remedy in the Attorney's Fees Awards Act generated remedial legislation.

### C. *Equal Access to Justice Act*

The enactment of the Equal Access to Justice Act[23] (EAJA) in 1980 improved taxpayers' prospects for recovering litigation costs.[24] EAJA awarded fees and costs to prevailing private parties in civil actions brought by or against the United States.[25] The Act precluded compensation to taxpayers when the position of the United States was substantially justified or special circumstances made an award unjust.[26] To be eligible for an award of costs, moreover, taxpayers

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17. *The Civil Rights Attorney's Fees Awards Act of 1976*, Pub. L. No. 94-559, 90 Stat. 2641 (1976) (codified as amended at 42 U.S.C. § 1988 (Supp. V 1981)); *see* S. REP. No. 1011, 94th Cong., 2d Sess. 4 (1976).

18. Before the Equal Access to Justice Act Amendments, the Civil Rights Attorney's Fees Awards Act of 1976 provided:

> [I]n any civil action or proceedings, by or on behalf of the United States of America, to enforce, or charging a violation of, a provision of the United States Internal Revenue Code of title VI of the Civil Rights Act of 1964, the court, in its discretion, may allow the prevailing party, other than the United States, reasonable attorney's fees as a part of the costs.

42 U.S.C. § 1988 (1976).

19. Id.

20. *See, e.g.*, Key Buick Co. v. Commissioner, 613 F.2d 1306, 1308 (5th Cir. 1980) (requiring that government initiate litigation for taxpayer to be eligible for fee award).

21. *See, e.g.*, Patzkowski v. United States, 576 F.2d 134, 139 (8th Cir. 1978) (discussing requirement of subjective bad faith by the government); Haskin v. United States, 444 F. Supp. 299, 304 (C.D. Cal. 1977) (discussing government's suit commenced in frivolous or harassing manner); *In re* Kline, 429 F. Supp. 1025, 1027 (D. Md. 1977) (court precluded fee-shifting despite government's knowledge of its "meritless" position); United States v. Garrison Constr. Co., 77-2 U.S. Tax Cas. (CCH) ¶ 9705, at 88,389 (N.D. Ala. 1977) (court adopted less stringent standard of "vexatious or harassing treatment not amounting to bad faith").

22. Only twice in two years were attorney's fees awarded. Note, *Taxpayers and the Civil Rights Attorney's Fees Awards Act of 1976,* 20 B.C.L. REV. 539, 553 (1979); *cf. In re* Slodov, 79-1 U.S. Tax Cas. (CCH) ¶ 9215, at 86,414 (N.D. Ohio 1979) (IRS's failure to honor prior agreement constituted bad faith); United States v. Garrison Constr. Co., 77-2 U.S. Tax Cas. (CCH) 9705 (N.D. Ala. 1977) (IRS's failure to inspect taxpayer's records before suit was unreasonable).

23. *Equal Access to Justice Act*, Pub. L. No. 96-481, 94 Stat. 2325 (1980) (codified as amended at 28 U.S.C. § 2412, 5 U.S.C. § 504 (Supp. 1983)).

24. Robertson & Fowler, *supra* note 9, at 903 (the Act "significantly increases the opportunities for small businesses, charitable organizations and other parties involved in court or agency litigation with the federal government to recoup their attorney's fees and other litigation expenses").

25. 28 U.S.C. § 2412(d)(1)(A) (Supp. 1983).

26. The relevant portion of EAJA provided:

> Except as otherwise specifically provided by statute, a court shall award to a prevailing

had to satisfy maximum net worth and business size limitations.[27]

Despite the modifications advanced by EAJA, fee-shifting in favor of prevailing tax litigants rarely occurred.[28] Based on statutory construction,[29] the federal judiciary denied EAJA's applicability to the United States Tax Court.[30] Because the vast majority of tax litigation occurred in Tax Court, few taxpayers successfully obtained fee awards.[31] Congress then intervened in 1982 by enacting section 7430.

## III. The Operation of I.R.C. § 7430

### A. *Section 7430 Generally*

Section 7430 awards reasonable litigation costs of up to $25,000 to taxpayers prevailing in civil tax actions in which the IRS assumed an unreasonable position.[32] The provision explicitly displaces EAJA's application to tax litigation

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party other than the United States fees and other expenses, in addition to any costs awarded pursuant to subsection (a), 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.

28 U.S.C. § 2412(d)(1)(a) (1982). Legislative history makes it clear that the government bears the burden of proving its position was substantially justified. H.R. Rep. No. 1418, 96th Cong., 2d Sess. 10 (1980). *See generally* Note, *Will the Sun Rise Again for the Equal Access to Justice Act?*, 48 Brooklyn L. Rev. 265, 285 (1982) (discussing the burden of proving "substantial justification").

27. *See* Equal Access to Justice Act, Pub. L. No. 96-481, tit. II, § 202(a), 94 Stat. at 2325 (1980); Robertson & Fowler, *supra* note 9, at 905 ("the Act is not intended to benefit parties with unlimited resources, but only those for whom financial considerations may be a significant deterrent to pursuing litigation").

The parties eligible for fee awards include: "[I]ndividuals with $1 million or less in net worth; businesses and public or private organizations with less than 501 employees and no more than $5 million in net worth; tax-exempt organizations (I.R.C. § 501(c)(3) (West Supp. 1985)) with less than 501 employees; and agricultural cooperatives with less than 501 employees." Robertson & Fowler, *supra* note 9, at 905-06.

28. *See* Note, *Tax Litigation and Attorney's Fees: Still a Win-Lose Dichotomy*, 57 S. Cal. L. Rev. 471, 479 (1984); *Attorney Fee Awards — Has the Bell Tolled Under the New Law?*, [1982] 10 Stand. Fed. Tax Rep. (CCH) ¶ 8375, at 8377.

29. EAJA applies only to courts created under article III of the United States Constitution; the Tax Court was created under article I, section 8, clause 9. Note, *Award of Attorney Fees in Tax Litigation*, 19 Val. U.L. Rev. 153, 156 (1984).

30. *See, e.g.*, Bowen v. Commissioner, 706 F.2d 1087 (11th Cir. 1983); McQuiston v. Commissioner, 78 T.C. 807, 811 (1982); Benson v. Commissioner, 45 T.C.M. 672, 673 (1983).

31. *See Commissioner's Annual Report Emphasizes Compliance Problems*, [1982] 10 Stand. Fed. Tax Rep. (CCH) ¶ 8324, at 8327 (discussing statistics of the Tax Court's dominance over tax decisions); Mandelkern, *Recovering Attorney's Fees in Tax Court Cases After TEFRA*, 57 Fla. B.J. 707 (1983).

32. I.R.C. § 7430(a), (b)(1), (c)(2) (West Supp. 1985). I.R.C. § 7430(a)(1), (2) (West Supp. 1985) provide:

(a) In general—In the case of any civil proceeding which is—

(1) brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, and

(2) brought in a court of the United States (including the Tax Court and the United States Claim Court), the prevailing party may be awarded a judgment for reasonable litigation costs incurred in such proceeding.

initiated after February 28, 1983.[33] Any party, other than the United States or the taxpayer's creditors, who is involved in suits relating to the collection or refund of any tax, interest, or penalty imposed by the Code is eligible for recompense.[34]

Section 7430 alters the coverage provided by EAJA in four principal respects. First, section 7430 provides for reimbursement in Tax Court proceedings.[35] Second, section 7430 effectively shifts the burden of proof to establish the character of the government's position from the government to the taxpayer.[36] Third, the provision alters the nature of the requisite standard in attorney's fee litigation.[37] Following a taxpayer's initiation of a suit for costs, EAJA required the government to establish the affirmative defense of "substantial justification."[38] Section 7430 now requires prevailing taxpayers to prove the unreasonableness of the government's position.[39] Finally, the new enactment mandates that otherwise eligible taxpayers exhaust their administrative remedies before resorting to litigation.[40] EAJA generally provided for reasonable litigation awards absent such a requirement.[41]

### B. *Mechanical Requirements of I.R.C. § 7430*

#### 1. Exhaustion of Administrative Remedies

To be eligible for an award of attorney's fees and costs under section 7430, a taxpayer must first exhaust all available administrative remedies within the IRS.[42] Inherent in this procedure is the taxpayer's participation in the proceedings and his responsibility to disclose all relevant information.[43] These good-

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33. 28 U.S.C. § 2412(e) (1981). Section 292(c) of TEFRA provides:

> Application of Title 28—Section 2412 of Title 28, United States Code, is amended by adding at the end thereof the following new subsection:
>
> "(e) The provisions of this section shall not apply to any costs, fees, and other expenses in connection with any proceeding to which section 7430 of the Internal Revenue Code of 1954 applies . . . ."

*See* McQuiston v. Commissioner, 78 T.C. 807, 811 (1982); Jenny v. Commissioner, 45 T.C.M. 440, 455 n.16 (1983).

34. I.R.C. § 7430(a)(1), (c)(2)(A) (West Supp. 1985).

35. I.R.C. § 7430(a)(2) (West Supp. 1985).

36. Pursuant to I.R.C. § 7430(c)(2)(A)(i) (West Supp. 1985), the taxpayer must establish the government's position was unreasonable. *See* S. REP. No. 530, 97th Cong., 2d Sess. 687 (1982); 127 CONG. REC. S 15594 (daily ed. Dec. 16, 1981). Under the EAJA, the Government must prove its action was substantially justified. *See supra* note 26 and accompanying text.

37. *See supra* note 36.

38. *See supra* note 26 and accompanying text.

39. I.R.C. § 7430(c)(2)(A)(i) (West Supp. 1985); *see infra* notes 60-65 and accompanying text.

40. I.R.C. § 7430(b)(2) (West Supp. 1985); *see infra* notes 42-52 and accompanying text.

41. 28 U.S.C. § 2412(d)(1)(B) (Supp. I 1983).

42. I.R.C. § 7430(b)(2) (West Supp. 1985).

43. Treas. Reg. § 301.7430-1(b)(2) (1984) provides that a party participates in the conference "if the party or qualified representative discloses to the Appeals office all relevant information regarding the party's tax matter to the extent such information and its relevance were known or should have been known to the party or qualified representative at the time of such conference." *See* HOUSE REPORT, *supra* note 3, at 13.

faith requirements promote pre-trial dispute resolution and help avoid the costs of actual litigation.[44]

IRS regulations prescribe procedures which satisfy the exhaustion of remedies prerequisites.[45] Absent exceptions permitting a bypass of the administrative process,[46] taxpayers must: (a) request an Appeals office conference;[47] (b) file a written protest if required;[48] (c) agree to extend the time for potential assessments when the Appeals office must consider the tax matter;[49] and (d) participate in the Appeals office conference if granted.[50] In addition to setting forth the framework for completing administrative prerequisites, the regulations provide illustrations of the applicable rules and exceptions.[51] The only aspect of section 7430 addressed in the regulations remains this exhaustion of administrative remedies requirement.[52]

### 2. Prevailing Party

To qualify for fee-shifting, a taxpayer must be a "prevailing party" as defined in section 7430.[53] The taxpayer must have "substantially prevailed" as to the amount in controversy[54] or as to the most significant issue or set of issues involved.[55] In the absence of an agreement by the parties, the court determines the prevailing party.[56] A taxpayer generally prevails by definition upon a showing of the government's unreasonableness.[57] When a case has not been brought in court, however, complications in the determination of the prevailing party may arise. The EAJA's definition of the term "prevailing" en-

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44. HOUSE REPORT, *supra* note 3, at 13; STAFF OF JOINT COMM. ON TAXATION, 97TH CONG., 1ST SESS., DESCRIPTION OF LAWS AND BILLS RELATING TO AWARDS OF ATTORNEY'S FEES IN TAX CASES 4 (Comm. Print 1981); *see* Mandelkern, *supra* note 31, at 708.

45. Treas. Reg. § 301.7430-1 (1984).

46. *Id.* § 301.7430-1(f)(1)-(4).

47. *Id.* § 301.7430-1(b)(ii)(A).

48. *Id.* § 301.7430-1(b)(ii)(B).

49. *Id.* § 301.7430-1(b)(ii)(C).

50. *Id.* § 301.7430-1(b)(2). Different procedures govern revocation of charitable organization status. *See* I.R.C. § 501(c)(3) (West Supp. 1985). In attempting to establish one's organization as a charitable organization, a party must exhaust all administrative remedies pursuant to I.R.C. § 7428. Treas. Reg. § 301.7430-1(c) (1984).

Actions involving summonses, levies, liens, jeopardy and termination assesments are governed by Treas. Reg. § 301.7430-1(d), which prescribes that a party must submit a written claim to the district director specifying the surrounding circumstances and nature of the requested relief. After the district director has either denied the claim in writing or failed to respond within a reasonable period, administrative remedies are considered exhausted.

51. Treas. Reg. § 301.7430-1(g) (1984) provides twelve examples illustrating operation of the exhaustion of remedies requirement.

52. Rubin, *Report on TEFRA Provisions with Respect to Award of Litigation Costs to Taxpayers and Increased Damages to the Government*, 62 TAXES 381, 384 (1984) ("it is understood that the IRS does not expect to issue regulations dealing with other aspects of Section 7430").

53. I.R.C. § 7430(c)(2)(A)(i) (West Supp. 1985).

54. *Id.* § 7430(c)(2)(A)(ii)(I).

55. *Id.* § 7430(c)(2)(A)(ii)(II).

56. *Id.* § 7430(c)(2)(B).

57. *Id.* § 7430(c)(2)(A)(i); *see* Note, *supra* note 28, at 489.

compassed settlement negotiations, voluntary dismissals and pre-trial motions.[58] Presumably, Congress intended section 7430 to include these same actions.[59]

### 3. Unreasonableness

The principal barrier in a taxpayer's attempt to effectuate fee-shifting remains establishing the unreasonableness of the government's position.[60] Rather than articulate a determinative test for unreasonableness, Congress enumerated the following criteria to be evaluated in conjunction with legal precedent and the facts in a given case:

> (1) whether the Government used the costs and expenses of litigation against its position to extract concessions from the taxpayer that were not justified under the circumstances of the case, (2) whether the Government pursued the litigation against the taxpayer for purposes of harassment or embarrassment, or out of political motivation, and (3) such other factors as the court finds relevant.[61]

Thus, the government's pursuit of a meritless legal position constitutes incontrovertible unreasonableness,[62] whereas the assumption of a substantively viable position does not.[63] Likewise, an effort by the IRS to sustain a position in a circuit which previously held for the taxpayer on the same issue would represent a paradigmatic example of unreasonableness.[64] By contrast, the IRS's attempt to create a conflict among United States Circuit Courts of Appeals is not unreasonable.[65]

### 4. Reasonable Litigation Costs

If, in the court's discretion,[66] a taxpayer qualifies for recoverable fees and costs, the reasonable litigation costs would include: (a) court costs; (b) expenses of expert witnesses relating to the proceedings; (c) the cost of any study, analysis, or report which the court finds necessary for preparing the case; and (d) attorney's fees in connection with the proceeding.[67] Congress, however, imposed

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58. H.R. REP. No. 96-1418, 96th Cong., 2d Sess. 11 (1980); *see* Environmental Defense Fund v. Watt, 554 F. Supp. 36, 39 (E.D.N.Y. 1982); Photo Data, Inc. v. Sawyer, 533 F. Supp. 348, 351 (D.D.C. 1982).

59. *See* Mandelkern, *supra* note 31, at 708.

60. I.R.C. § 7430(c)(2)(A)(i) (West Supp. 1985); *see* Note, *supra* note 28, at 482-83.

61. H.R. REP. No. 404, *supra* note 3, at 12.

62. *See* Note, *supra* note 28, at 486 ("courts may award attorney's fees for governmental procedural abuse alone").

63. *See generally* Rubin, *supra* note 54, at 381-87 (discussing what is "unreasonable").

64. *See* Ashburn v. United States, 740 F.2d 843 (11th Cir. 1984) (EAJA decision where government had taken the same position many times previously without ever having succeeded).

65. H.R. REP. No. 404, *supra* note 3, at 12. *See* Ellentuck, Holub & Solomon, *Attorneys' Fees Awards in Tax Litigation Now Available to Successful Litigants*, 46 J. TAX'N 157 (1977).

66. I.R.C. § 7430(a) (West Supp. 1985) provides that a party "may" be awarded reasonable litigation costs.

67. I.R.C. § 7430(c)(1)(A), (B) (West Supp. 1985).

limits on the Code's fee-shifting provisions.[68] In addition to a $25,000 ceiling on the award of reasonable litigation costs,[69] the expenses are compensable only to the extent they are allocable to the United States and not to another party to the proceeding.[70]

## IV. Underlying Action v. Litigation Position

### A. *Section 7430*

One of the most litigated legal issues in the scheme of fee-shifting is the breadth of "the position of the United States"[71] in the determination of unreasonableness.[72] Federal courts disagree over whether an award of fees extends to the government's unjustified conduct in the entire dispute or merely to government actions subsequent to the filing of the suit.[73] The discord results from section 7430's failure to specify whether the term "position" refers to the government's conduct precipitating the suit or its conduct during litigation.[74] The legislative history of section 7430 provides only limited assistance in interpreting the provision.[75]

#### 1. Underlying Action Theory

Only two federal courts of appeals have directly addressed the scope of

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68. *Id.* § 7430(b). In addition, courts may attempt to apportion fee awards when a taxpayer only partially prevails. *See* Note, *supra* note 28, at 491 n.145.

69. I.R.C. § 7430(b)(1) (West Supp. 1985). TEFRA's approach differs from EAJA, in which eligibility was contingent upon net worth and size limitations, and eligible parties could generally recover all of their attorney's fees. *See supra* note 27 and accompanying text. In any event, both provisions attempt to serve parties likely to be deterred from litigation because of costs. *See* 127 Cong. Rec. H 9617 (daily ed. Dec. 15, 1981).

70. I.R.C. § 7430(b)(3) (West Supp. 1985).

71. *Id.* § 7430(c)(2)(A)(i) (West Supp. 1985).

72. *See infra* notes 73-185 and accompanying text.

73. *See* Kaufman v. Egger, 758 F.2d 1, 4 (1st Cir. 1985) ("civil proceeding" includes pre-litigation activities); Sharpe v. United States, 607 F. Supp. 4,7 (E.D. Va. 1984); *cf.* Penner v. United States, 584 F. Supp. 1582 (S.D. Fla. 1984); Hallam v. Murphy, 586 F. Supp. 1,3 (N.D. Ga. 1983). *But see* United States v. Balanced Fin. Mgmt., Inc., 769 F.2d 1440 (10th Cir. 1985) ("civil proceeding" precludes pre-litigation activities); Contini v. United States, 84-2 U.S. Tax Cas. (CCH) ¶ 9969 (N.D. Cal. 1984); Brazil v. United States, 84-2 U.S. Tax Cas. (CCH) ¶ 9596 (D. Or. 1984); Zielinski v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 9514 (D. Minn. 1984); Eidson v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 9182 (N.D. Ala. 1984); Baker v. Commissioner, 83 T.C. 822 (1984); Spirtis v. Commissioner, 49 T.C.M. (CCH) 610 (1985); Powell v. Commissioner, 49 T.C.M. (CCH) 323 (1985).

74. I.R.C. § 7430(c)(3) (West Supp. 1985) merely provides that "civil proceeding" includes a civil action.

75. H.R. Rep. No. 404, *supra* note 3, at 12; *see* Note, *Attorney's Fees in Tax Cases After the Tax Equity and Fiscal Responsibility Act of 1982*, 36 Tax Law. 123, 152 (1982) ("neither the language of the Act nor the legislative history indicates conclusively whether the term 'government's position' refers to the government's litigation position or to its conduct and actions generally in the course of the civil proceeding"); Mandelkern, *supra* note 31 ("it is unclear from the legislative history whether the 'position of the United States in the civil proceeding' means its position in the litigation or its position during the taxpayer's audit and administrative appeal").

section 7430's coverage. In *Kaufman v. Egger*,[76] the First Circuit Court of Appeals held that section 7430's award of costs encompassed pre-litigation conduct by the IRS.[77] The court awarded attorney's fees and litigation costs to taxpayers victimized by bureaucratic "bungling."[78] The taxpayers in *Kaufman* filed their 1978 individual income tax return early in 1979.[79] Subsequently, they moved from their Illinois residence to Maine.[80] In 1980, the IRS sent an audit notice to their former Illinois address.[81] That same year, the IRS mailed a statutory notice of deficiency and an increased tax liability assessment to a separate Illinois address where the taxpayers never resided.[82] Upon discovering the mistakes in 1983, the IRS seized a refund as partial payment of over $23,000 in back taxes.[83] The taxpayers instituted an action seeking a temporary restraining order.[84] In response, the IRS stipulated to the permanent injunction, preventing any further action on collection of the deficiency.[85] The district court subsequently awarded attorney's fees and litigation costs to the taxpayers.[86]

Affirming the district court's award, the circuit court in *Kaufman* analyzed the several prerequisites to the successful application of section 7430. In response to the IRS's contention that the taxpayer failed to exhaust available administrative remedies,[87] the court found the taxpayer's immediate resort to litigation permissible given the government's intrinsic unreasonableness.[88] The court relied on section 7430's legislative history[89] and the regulations addressing the exhaustion of remedies requirement.[90]

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76. 758 F.2d 1 (1st Cir. 1985).

77. *Id.* at 4. The other court of appeals confined I.R.C. § 7430's coverage to the government's litigation position. *See infra* notes 138-150 and accompanying text.

78. *Id.* at 2. "The present case zeros in on one of many unnecessary tribulations that can be brought to bear upon the unsuspecting citizenry by today's computerized bureaucracy." *Id.* at 1.

79. *Id.* at 2.

80. *Id.*

81. *Id.* The IRS Chicago office, where the Kaufmans filed their 1978 tax return, had in its file an IRS "Transcript of Account" indicating the Kaufmans' correct address in Maine. Due to the Kaufmans' absence from the audit, their tax liability increased by $14,380.

82. *Id.* The address was that of another couple by the same name. The IRS acknowledged its mistake in a memo placed in the Kaufmans' file eleven days later. In the interim, the IRS was corresponding with the Kaufmans at their Maine address about other matters.

83. *Id.* This was the first notification the Kaufmans received regarding the deficiencies. By this time, the Taxpayers Delinquent Account section had taken over.

84. *Id.*

85. *Id.*

86. 548 F. Supp. 872 (D. Me. 1984).

87. The IRS claimed the Kaufmans should have attempted to correct the 1978 deficiency at the agency level. *Id.* at 3.

88. "[T]he Kaufmans can hardly be faulted for seeking immediate judicial relief." *Id.*

89. H.R. REP. No. 404, *supra* note 3, at 13; STAFF OF SENATE COMM. OF FINANCE: TECHNICAL EXPLANATIONS OF COMMITTEE AMENDMENT, *reprinted in* 127 CONG. REC. S 15,559 (daily ed. Dec. 16, 1981) [hereinafter cited as TECHNICAL EXPLANATION] (taxpayers must exaust administraive remedies unless the court determines the case does not warrant such requirement).

90. Pursuant to Treas. Reg. § 301.7430-1(F)(3)(ii) (1984), the IRS considers administrative appeals exhausted when the party

[d]id not receive a preliminary notice of proposed disallowance prior to issuance of a

The government also contended that "the position of the United States in the civil proceeding"[91] referred only to litigation-related proceedings occurring after the initiation of a suit.[92] The *Kaufman* court acknowledged the division of authority in cases directly addressing the issue[93] but ultimately rejected the government's position. The court relied on congressional committee reports suggesting the prevailing taxpayer should obtain fees in civil tax actions whenever the IRS behaves unreasonably in pursuing the case.[94] Interpreting the Code language broadly,[95] the court reaffirmed the provision's purpose to deter abusive conduct and overreaching of the IRS.[96] Permitting the IRS to escape attorney's fee liability when it harasses a taxpayer at the administrative stage but alters its position after the suit commences would frustrate the congressional purpose.[97]

Those federal district courts that have interpreted section 7430's "position of the United States" language have applied similar reasoning. On parallel facts, the court in *Hallam v. Murphy*[98] tested the government's conduct throughout the entire tax proceeding, not merely subsequent to the suit's inception.[99] The government had continuously pursued an erroneous position, and had failed to notify the taxpayers of the deficiency.[100] The court found this position to be per se unreasonable and granted the taxpayers' motion for costs and fees.[101]

In *Penner v. United States*,[102] the government initiated a jeopardy assessment against a taxpayer prior to trial. The District Court for the Southern District of Florida responded by awarding the taxpayer reasonable litigation costs.[103] Recognizing the dearth of legislative history underlying section 7430's enactment,[104] the court indicated Congress could have clearly restricted fee-shifting

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statutory notice of disallowance and the failure to receive such notice was not due to actions of the party (such as the failure to supply requested information or a current mailing address to the district director or service center having jurisdiction over the tax matter). *Id.*

91. I.R.C. § 7430(c)(2)(A)(i) (West Supp. 1985).

92. *Kaufman*, 758 F.2d at 3.

93. *Id.* at 4; *see supra* note 73.

94. TECHNICAL EXPLANATION, *supra* note 89, at S 15594.

95. The court reasoned that Congress' remedial bias in enacting I.R.C. § 7430 dictates the inclusion of pre-litigation conduct. *Kaufman*, 758 F.2d at 4.

96. *Id.*; *see* H.R. REP. No. 404, *supra* note 3, at 11.

97. "Congress did not intend to dissuade taxpayers who, prior to filing a suit, were faced with unreasonable conduct by the IRS." *Kaufman*, 758 F.2d at 4.

98. 586 F. Supp. 1 (N.D. Ga. 1983).

99. *Id.* at 3.

100. *Id.*

101. The court considered the IRS' "continued assertion of a position with knowledge that the position is based upon an erroneous assumption" to be per se unreasonable. *Id.*

102. 584 F. Supp. 1582 (S.D. Fla. 1984).

103. *Id.* at 1584.

104. Concluding the legislative history provided little guidance, the *Penner* court quoted a House Conference Report accompanying TEFRA which stated "[t]he taxpayer may recover litigation costs only if the position of the United States in the case was unreasonable." H.R. CONF. REP. No. 760, 97th Cong., 2d Sess. 686, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 781, 1449. The determinative issue was whether "case" referred only to litigation or to the entire tax matter. *Penner*, 584 F. Supp. at 1584.

to situations of unreasonable trial posture.[105] Absent such evidence of congressional intent, the court found no rational basis for distinguishing between the government's administrative position and its trial position.[106]

Comparing the language and legislative histories of TEFRA and EAJA, one federal district court concluded the addition of the administrative remedies requirement in TEFRA demonstrated a congressional intention to include prelitigation conduct within the scope of unreasonableness.[107] By defining the term "civil proceeding" to include a civil action,[108] section 7430 implies that the phrase covers more than just civil actions.[109] Otherwise, the IRS could assume an unreasonable administrative position and abandon it before trial without fear that the taxpayer would recover reasonable litigation expenses.[110]

### 2. Litigation Position Theory

One circuit court[111] and the balance of district courts diametrically opposed to the *Kaufman* position propound an alternative interpretation of section 7430's coverage. Significantly, the Tax Court has consistently confined its application of "reasonableness" to the government's litigation posture.[112] In assuming the "litigation" stance, these courts isolate the government's litigation position from the underlying factual and procedural background of the case.[113]

In *Eidson v. United States*,[114] the District Court for the Northern District of Alabama denied a taxpayer's motion for fees upon a showing that the government had deferred a full refund of the amount claimed by the taxpayer until trial.[115] The court predicated its decision on what it regarded as a dispositively clear provision of the Code.[116] Specifically, the *Eidson* court equated the term "civil proceeding" with actual litigation and denied any reference to the underlying administrative procedure.[117] The court echoed the taxpayer's concern that the IRS should act reasonably both in litigation and in its underlying

105. *Id.* at 1584. The statute could have provided "the position of the United States in presenting a defense in the civil proceeding." *Id.* at 1583.

106. *Id.* "If the Government's position in initiating the jeopardy assessment was found to be unreasonable . . . , it is hard to fathom how the Government's position (in defending an unreasonable action) would be reasonable." *Id.*

107. Sharpe v. United States, 607 F. Supp. 4 (E.D. Va. 1984).

108. I.R.C. § 7430(c)(3) (West Supp. 1985).

109. Sharpe v. United States, 607 F. Supp. 4, 8 (E.D. Va. 1984).

110. *Id.*

111. *See infra* notes 136-148 and accompanying text.

112. *See* Spritis v. Commissioner, 49 T.C.M. (CCH) 610 (1985); Powell v. Commissioner, 49 T.C.M. (CCH) 540 (1985); Popham v. Commissioner, 49 T.C.M. (CCH) 323 (1984); Baker v. Commissioner, 83 T.C. 822 (1984).

113. *See Award of Attorneys Fees in Tax Cases: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. of Ways and Means*, 99th Cong., 1st Sess. 55 (1985) (referring to Moats v. United States, 576 F. Supp. 1537, 1541 (W.D. Mo. 1984)).

114. 84-1 U.S. Tax Cas. (CCH) ¶ 9182 (N.D. Ala. 1984).

115. *Id.* at 83,274.

116. The taxpayer must demonstrate the position of the IRS "in the civil proceeding" was unreasonable. I.R.C. § 7430(c)(2)(A)(i) (West Supp. 1985).

117. *Eidson*, 84-1 U.S. Tax Cas. (CCH) at 83,273.

administration.[118] Nonetheless, the court held that an award of fees based on the government's administrative position would contravene the explicit language of section 7430.[119]

In addition to focusing on section 7430's express language, courts have contrasted its legislative history with that of EAJA.[120] The Tax Court demonstrated such an approach in *Baker v. Commissioner*. [121] The IRS assessed tax deficiencies on a taxpayer based on its allowance of a foreign earned income exclusion. The taxpayer pursued a protest and filed a petition.[122] The IRS conceded its error only after the taxpayer submitted information the IRS had requested.[123] After determining the government's pursuit was legally justified,[124] the court restricted the examination of reasonableness to the IRS's position during the litigation.[125] Like the court in *Eidson*, the *Baker* court narrowly construed the term "civil proceeding" to denote the government's trial posture.[126] The court relied on section 7430's legislative history indicating that costs incurred during the administrative stages of a case were irrecoverable under an award of fees.[127] Finally, the court cited a series of cases under EAJA providing some criteria for the determination of unreasonableness.[128]

The *Baker* court substantiated its narrow construction of a "civil proceeding" with a cursory reference to section 7430's legislative history.[129] However, the House Committee discussion cited by the court addressed a different issue than that faced by the court. The Committee report explains the potentially compensable costs in tax litigation.[130] In particular, the reference suggests pre-lit-

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118. *Id.* at 83,274.

119. *Id.*

120. *See infra* notes 186-187 and accompanying text.

121. 83 T.C. 822 (Nov. 28, 1984).

122. *Id.* at 3853-54.

123. *Id.* at 3855.

124. *Id.* The substantive issue under I.R.C. § 911(c)(1)(B) (West Supp. 1985) was an issue of first impression in the court. The IRS's position was thus not in conflict with other decisions. 83 T.C. 822, at 3857. The fact that the IRS required information regarding the taxpayer's statements as a prerequisite to conceding the case was not unreasonable. *Id.* at 3858. *See* Greenberg v. United States, 83-1 U.S. Tax Cas. (CCH) ¶ 9257 (1983); Allen v. United States, 547 F. Supp. 357, 360 (N.D. Ill. 1982) (cases decided pursuant to EAJA).

125. *Baker*, 83 T.C. 822, at 3856.

126. *Id.* The court reasoned Congress distinguished a civil proceeding from an administrative one by the exhaustion of remedies prerequisite to an award of fees and costs. *See* I.R.C. § 7430(b)(2) (West Supp. 1985).

127. H.R. REP. No. 404, *supra* note 3, at 14.

128. *See, e.g.*, Ashburn v. United States, 740 F.2d 843, 850 (11th Cir. 1984) (standard is one of reasonableness which must be shown both in law and fact); Foster v. Tourtellotte, 704 F.2d 1109, 1112 (9th Cir. 1983) (court employed reasonableness standard); S & H Riggers & Erectors, Inc. v. O.S.H.R.C., 672 F.2d 426, 430 (5th Cir. 1982) ("test of whether or not a government action is substantially justified is essentially one of reasonableness").

129. *Baker*, 83 T.C. 822, at 3856.

130. "The committee intends that the costs of preparing and filing the petition or complaint which commences a civil tax action be the first of any recoverable attorney's fees. Fees paid or incurred for the services of an attorney during the administrative stages of the case could not be recovered under an award of litigation costs." H.R. REP. No. 404, *supra* note 3, at 14.

igation "costs" are not recoverable.[131] By contrast, the issue presently raised is whether the government's unreasonable pre-litigation "conduct" can provide the basis for an award of attorney's fees under section 7430.[132] The compensability of pre-litigation costs is not disputed. The court's misinterpretation of legislative history substantially attenuates *Baker*'s precedential value.[133]

Neither *Eidson* nor *Baker* articulated a compelling basis for the restrictive interpretation of the "position" of the IRS in an action or proceeding. Admittedly sympathizing with the plaintiff,[134] the *Eidson* court nevertheless summarily disposed of the conflict by interpreting an historically ambiguous phrase in a circuitous manner.[135] The inconsistent decisions interpreting section 7430's "in a civil proceeding" language refute the *Eidson* court's position that the meaning of the phrase is self-evident.

The most recent decision to interpret the government's "position" under section 7430 analogized the statute to EAJA and arrived at a more cogent determination. In *United States v. Balanced Financial Management*,[136] the government attorney failed to attend a court-ordered hearing requiring the taxpayers to show cause why they should not be held in contempt.[137] The district court granted the taxpayers' motion to dismiss due to the government's failure to prosecute properly.[138] In addition, the court awarded attorney's fees and litigation costs pursuant to section 7430.[139] The Tenth Circuit Court of Appeals reversed the award of fees.[140] The court held the attorney's absence did not render the government's position in the underlying contempt proceeding unreasonable.[141]

The court in *Balanced Financial Management* first acknowledged the functional similarities between EAJA and section 7430.[142] Reasoning that EAJA was not intended to penalize the government for committing procedural defaults,[143] the court concluded the government's failure to attend the contempt hearing likewise fell short of activating section 7430.[144] In determining unreasonableness, the

131. *Id.*

132. *See* text accompanying note 5.

133. Specifically, the court read the legislative history to provide that IRS pre-litigation conduct cannot trigger I.R.C. § 7430. The court erred in such an interpretation since the language merely indicated pre-litigation costs are not compensable under I.R.C. § 7430. *Baker*, 83 T.C. 822 (1984).

134. *Eidson*, 84-1 U.S. Tax Cas. (CCH) at 83,274.

135. The issue was whether the phrase, "in the civil proceeding," referred to the pre-litigation or post-filing position of the United States. The court concluded that the use of "in the civil proceeding" mandated the test of the "reasonableness of the government's position in the civil proceeding, not the underlying administrative procedure." *Id.* at 83,273.

136. 769 F.2d 1440 (10th Cir. 1985).

137. *Id.* at 1443.

138. *Id.*

139. *Id.*

140. *Id.* at 1451. The court affirmed the dismissal of the contempt proceeding.

141. *Id.* at 1450-51.

142. The court stated the standards of "substantially justified" under EAJA and "unreasonable" under I.R.C. § 7430 were comparable. *Id.* at 1451 n.12.

143. *Id.* (citing McDonald v. Schweiker, 726 F.2d 311, 316 (7th Cir. 1983)).

144. The court held the attorney's absence from the hearing "does not render the institution of the contempt proceedings or the Government's position in that underlying contempt proceeding unreasonable." 769 F.2d at 1451.

court confined its interpretation of "position" to the government's legal posture in litigation.[145]

*Balanced Financial Management* is readily distinguishable from *Eidson* and *Baker* inasmuch as the government's conduct lacked the reprehensibility of the conduct in the latter cases.[146] The government's failure to attend the hearing was a mere procedural default rather than a substantive error. Undertaking the contempt proceeding was neither legally nor factually unreasonable.[147] Given the limited nature of the government's unreasonableness,[148] the Tenth Circuit refused to grant the taxpayers' motion for fees.

### B. *Equal Access to Justice Act*

The Equal Access to Justice Act's provision for the award of attorney's fees and litigation costs produced a judicial controversy parallel to that encountered with section 7430. Courts interpreting the Act recognized the fundamental problem Congress created by failing to define "position."[149] Circuits disagreed on whether the term referred to the agency's underlying action or the government's conduct in the litigation.[150] In 1984, Congress unanimously passed a bill prolonging EAJA's life and defining "position" to include the government's underlying administrative action.[151] President Reagan, however, vetoed the provision.[152] Unlike section 7430, EAJA provides for fee awards in any civil

145. *Id.* at 1450. The court concluded the Government's "position" meant "the arguments relied upon by the Government in litigation." *See* United States v. 2,116 Boxes of Boned Beef, 726 F.2d 1481, 1487 (10th Cir.), *cert. denied*, 105 S. Ct. 105 (1984).

146. *See supra* note 114-35 and accompanying text.

147. *Balanced Fin. Mgmt.*, 769 F.2d at 1443, 1451 n.12.

148. Although the Government erred in failing to appear at the contempt proceeding, its substantive position in commencing the contempt proceeding was not unreasonable. There was presumably less "bad faith" on the part of the Government. *Balanced Fin. Mgmt.*, 769 F.2d at 1451 n.12.

149. *See* Note, *Reenacting the Equal Access to Justice Act: A Proposal for Automatic Attorney's Fee Awards*, 94 YALE L.J. 1207, 1214-16 (1985) ("the most important area of disagreement that has developed under the Act is an unanticipated split among the circuits as to what Congress meant when it referred to the 'position' of the United States").

150. *See, e.g.*, Keasler v. United States, 766 F.2d 1227, 1231 (8th Cir. 1985) (the "position" of the United States encompasses the government's posture at both the pre-litigation and litigation stages); Timms v. United States, 742 F.2d 489, 492 (9th Cir. 1984) ("the remedial purpose of EAJA is best effectuated if we consider the totality of the circumstances present prior to and during litigation" (citing Rawlings v. Heckler, 725 F.2d 1192, 1196 (9th Cir. 1984))); Natural Resources Defense Council v. U.S.E.P.A., 703 F.2d 700, 707 (3d Cir. 1983) (consistent with "its plain meaning and the intention of Congress . . . position refers to the agency action which made it necessary for the party to file suit"). *But see, e.g.*, Ashburn v. United States, 740 F.2d 843, 849 (11th Cir. 1984) (to avoid an automatic fee award, "interpreting 'position' as the government's litigation position best implements the legislative compromise embodied in the EAJA"); Spencer v. NLRB, 712 F.2d 539, 552-53 (D.C. Cir. 1983), *cert. denied*, 104 S. Ct. 1908 (1984) (Congress intended an "intermediate" standard for the award of fees with a view toward the agency's litigation position); Tyler Business Servs., Inc. v. NLRB, 695 F.2d 73, 75 (4th Cir. 1982) ("position" means government's posture in defending litigation).

151. H.R. 5479, 98th Cong., 2d Sess., 130 CONG. REC. S 14387 (daily ed. Oct. 11, 1984).

152. 20 WEEKLY COMP. OF PRES. DOC. 1814 (Nov. 1984). The President vetoed the provision because congress included the underlying agency action within the definition of "position." *See Equal Access Reauthorization Pocket Vetoed by President*, 42 CONG. WEEKLY REP. 2964 (1984).

litigation.[153] Like its successor, EAJA fosters uncertainty in fee-shifting where the government's conduct is nonmeritorious.

### 1. Underlying Action Theory

Case law defining the government's "position" as encompassing the agency action necessitating a lawsuit generally relied on supportive legislative history.[154] For instance, the Senate Report explicitly conferred "prevailing party" status on the beneficiary of a settlement.[155] Courts determined that Congress' reference to settlement clearly indicated the word "position" encompassed both the IRS's administrative and litigation behavior.[156] In addition, the Senate Report suggested the underlying administrative actions should be examined in prescribing fee awards.[157]

Floor discussion clarified congressional understanding of the government's "position." Debate concerning actionable conduct was replete with references to governmental action,[158] capricious and arbitrary federal regulation,[159] and irresponsible bureaucratic behavior.[160] Senator Nelson articulated EAJA's salutary effects as twofold: redressing the victims of government wrongdoing, and restraining insensitive, arbitrary or irresponsible regulators.[161] Restricting the Act to the government's litigation position and ignoring the administrative action that compelled the lawsuit would remove the very incentive Congress furnished.[162] Moreover, the Act defines the "United States" as including all agencies and officials of the government acting in their official capacities.[163] This definition, encompassing administrative agencies, clearly supports the underlying action theory.

*Britton v. United States*[164] illustrates the underlying action doctrine's expansive definition of "position." In *Britton*, the IRS imposed an assessment for unpaid

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153. 28 U.S.C. § 2412(d)(1)(A) (1982); *see supra* note 26 and accompanying text.

154. *See* Keasler v. United States, 766 F.2d 1227, 1231 (8th Cir. 1985); Natural Resources Defense Council v. U.S.E.P.A., 703 F.2d 700, 707-12 (3d Cir. 1983); Citizens Coal. for Block Grant Compliance v. City of Euclid, 717 F.2d 964, 966 (6th Cir. 1983).

155. S. REP. No. 253, 96th Cong., 1st Sess. 7, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4984, 4990.

156. Natural Resources Defense Council v. U.S.E.P.A., 703 F.2d 700, 708 (3d Cir. 1983) ("The reference to settlements makes plain that 'position of the United States' must have been meant to include not only the litigation position, which will more often than not be determined by the Justice Department, but also the agency position which made the lawsuit necessary.").

157. S. REP. No. 253, *supra* note 156, at 15, *reprinted in* 1980 U.S. CODE CONG & AD. NEWS 4984, 4993.

158. 125 CONG. REC. S 10914 (daily ed. July 31, 1979) (statement of Sen. DeConcini).

159. *Id.* at S 10916 (statement by Sen. DeConcini) ("the purpose is to readjust the position between the Government acting in its regulatory capacity and individual rights").

160. *Id.* at S 10917 (statement by Sen. Thurmond) ("the implicit assumption in the approach taken by this legislation is that affecting the 'pocketbook' of the agency is the most direct way to assure more responsible bureaucratic behavior").

161. *Id.* at S 10922.

162. Natural Resources Defense Council v. U.S.E.P.A., 703 F.2d 700, 710 (3d Cir. 1983).

163. 28 U.S.C. § 2412(d)(2)(c) (1982).

164. 587 F. Supp. 834 (W D. Mo. 1984).

withholding taxes on a company's bookkeeper.[165] Rather than consider evidence that the bookkeeper was not legally responsible,[166] the IRS threatened litigation unless the taxes were paid.[167] The bookkeeper paid the amount and initiated a refund action.[168] The IRS learned of its mistake through discovery and granted the plaintiff bookkeeper a complete settlement.[169]

Reasoning the IRS never held information indicating the plaintiff was an officer responsible for payment of taxes,[170] the *Britton* court awarded attorney's fees and litigation costs.[171] The court justified its decision in part on the government's failure to apprise the plaintiff of the proposed assessment and lien.[172] In addition, the court deemed the government's repeated disregard of determinative evidence at each administrative stage a classic example of indifference and unreasonableness.[173] To have meaning, a fee award must recompense innocent prevailing taxpayers who are forced into court.

### 2. Litigation Position Theory

Despite apparent congressional support for awards based on IRS pre-litigation conduct,[174] several courts have endorsed the litigation position theory.[175] Recognizing that EAJA fails to explicate the word "position,"[176] litigation theory proponents attempt to neutralize the Act's definition of the "United States" with an alternative, though similarly indirect, provision of EAJA.[177] Section 2412(d)(3) of EAJA instructs a court reviewing administrative agencies' adversary adjudications to award fees unless the position of the United States can be substantially justified or circumstances make fee-shifting unjust.[178] Courts advocating the litigation position doctrine presume the "position" of the United States refers to its litigation posture before the agency.[179]

165. *Id.* at 835.

166. *Id.* The bookkeeper offered a notorized letter to the IRS revenue officer. The letter, from the company's president, clearly stated the plaintiff was not a corporate officer and that the president was responsible for the taxes. The IRS refused to investigate the matter. *Id.*

167. *Id.* at 836.

168. *Id.*

169. *Id.* The IRS unduly delayed both the settlement negotiations and the eventual disbursement of a refund check. *Id.*

170. *Id.* at 838.

171. *Id.* at 840.

172. *Id.* "Instead, the gears of bureaucracy creaked into motion without warning, and plaintiff became grist for the IRS mill." *Id.*

173. *Id.* at 839. Upon learning of the assessment and lien, the plaintiff diligently approached the IRS with evidence that he was not responsible for the taxes. *Id.*

174. *See supra* notes 154-73 and accompanying text.

175. *See supra* note 150; *see, e.g.*, Gava v. United States, 699 F.2d 1367 (Fed. Cir. 1983); Broad Ave. Laundry & Tailoring v. United States, 693 F.2d 1387 (Fed. Cir. 1982); Alspach v. District Director of Internal Revenue, 527 F. Supp. 225 (D. Md. 1981).

176. *See* Natural Resources Defense Council v. U.S.E.P.A., 703 F.2d 700, 706 (3d Cir. 1983); Spencer v. NLRB, 712 F.2d 539, 547 (D.C. Cir. 1983), *cert. denied*, 104 S. Ct. 1908 (1984).

177. Spencer v. NLRB, 712 F.2d 539, 547 (D.C. Cir. 1983), *cert. denied*, 104 S. Ct. 1908 (1984).

178. 28 U.S.C. § 2412(d)(3) (1982).

179. Ashburn v. United States, 740 F.2d 843, 848 (11th Cir. 1984); Spencer v. NLRB, 712 F.2d 539, 547-48 (D.C. Cir. 1983), *cert. denied*, 104 S. Ct. 1908 (1984).

Like the underlying action proponents, litigation position advocates obtain support from EAJA's legislative history.[180] Committee reports describe the standard of liability in terms of the government's ability to substantiate "its case" legally and factually.[181] Additionally, congressional debates make reference to the IRS's unreasonableness "in pursuing the litigation"[182] and in "its decision to litigate."[183] Finally, Congress expressed fear over the exorbitant costs associated with an automatic fee-shifting provision.[184] Consistent with the intermediate "substantial justification" standard, some courts contend Congress intended the litigation position theory for EAJA.[185]

### C. *Interaction of I.R.C. § 7430 and EAJA*

The evolution of case law under EAJA and section 7430 reveals a judicial impasse with regard to the awarding of fees. The respective legislative histories fail to provide a clear-cut view. In reviewing section 7430 in light of EAJA policy and precedent, most courts underscore similarities between the acts and incorporate EAJA's legislative history.[186] This practice, undertaken because of the comparatively sparse legislative history behind section 7430, has further confused the interpretation of section 7430. Some jurisdictions distinguish EAJA's provision to effectuate a particular result.[187] The balance of courts analyze the enactments without reciprocal reference.[188] Given the trend for independent review in some circuits, the likelihood of consistent judicial resolution of the underlying action/litigation position dichotomy is remote.

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180. *See* Spencer v. NLRB, 712 F.2d 539, 547-53 (D.C. Cir. 1983), *cert denied*, 104 S. Ct. 1908 (1984).

181. H.R. REP. No. 1418, 96th Cong., 2d Sess. 10 (1980) S. REP. No. 253, *supra* note 155, at 6.

182. H.R. REP. No. 1418, *supra* note 181, at 11; S. REP. No. 253, *supra* note 155, at 6-7.

183. H.R. REP. No. 1418, *supra* note 181, at 11; S. REP. No. 253, *supra* note 155, at 6-7.

184. H.R. REP. No. 1418, *supra* note 181, at 6.

185. *See, e.g.*, Spencer v. NLRB, 712 F.2d 539, 551 (D.C. Cir. 1983), *cert. denied*, 104 S. Ct. 1908 (1984). "This standard balances the constitutional obligation of the executive branch to see that the laws are faithfully executed against the public interest in encouraging parties to vindicate their rights." H.R. REP. No. 1418, *supra* note 181, at 10; S. REP. No. 253, *supra* note 155, at 6, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4953, 4989.

186. *See, e.g.*, United States v. Balanced Fin. Mgmt., 769 F.2d 1440 (10th Cir. 1985); Brazil v. United States, 84-2 U.S. Tax Cas. (CCH) ¶ 9596 (D. Ore. 1984); Sharpe v. United States, 607 F. Supp. 4 (E.D. Va. 1984); Baker v. Commissioner, 83 T.C. 822 (1984); Popham v. Commissioner, 49 T.C.M. (CCH) 323 (1984); *see also* Note, *supra* note 28, at 480-83 ("Many of the conclusions regarding the EAJA, however, are applicable to section 7430 and thus many of the precedents scrutinized in the analysis of TEFRA below are derived from EAJA case law.").

187. *See, e.g.*, Zielinski v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 9514 (D. Minn. 1984); Sharpe v. United States, 607 F. Supp. 4 (E.D. Va. 1984); Eidson v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 9182 (N.D. Ala. 1984); Popham v. Commissioner, 49 T.C.M. 323 (1984).

188. *See, e.g.*, Kaufman v. Egger, 758 F.2d 1 (1st Cir. 1985); Contini v. United States, 84-2 U.S. Tax Cas. (CCH) ¶ 9969 (N.D. Cal. 1984); Penner v. United States, 584 F. Supp. 1582 (S.D. Fla. 1984); Hallam v. Murphy, 586 F. Supp. 1 (N.D. Ga. 1983); Spirtis v. Commissioner, 49 T.C.M. (CCH) 611 (1985); Powell v. Commissioner, 49 T.C.M. (CCH) 611 (1985); Powell v. Commissioner, 49 T.C.M. (CCH) 540 (1985).

## V. Adopting the Underlying Action Doctrine

Due to disparate interpretations of the phrase "position in a civil proceeding," section 7430's effect on attorney's fee recovery has proven negligible.[189] The underlying action theory for the award of attorney's fees and litigation costs serves remedial and deterrent purposes which are fundamental to any system of fee-shifting.[190] The equity and fairness advanced under such a system may be achieved at minimal cost to the government.

Courts adopting the litigation position make an arbitrary distinction by extricating the IRS's litigation position from the factual background of a case.[191] Limiting the examination of unreasonableness to the government's litigation position undermines the idea of a fee incentive.[192] Because taxpayers cannot anticipate the IRS's legal arguments, their ability to assess the likelihood of a fee award is substantially impaired.[193] The superior resources of the IRS further magnifies the imbalance between the parties.[194] By adopting the underlying action form of fee-shifting, Congress could prevent the disproportionate advantage otherwise accorded the IRS in tax litigation.[195]

Litigation expenses often impede a taxpayer from suing the IRS on a meritorious claim.[196] The taxpayer's cost frequently transcends any benefits obtained from litigation.[197] Due to these economic risks, taxpayers do not casually undertake a section 7430 motion for litigation costs. Congress attempted to remedy the financial injury by providing fee awards to victims of indefensible governmental conduct.[198] Taxpayers otherwise unable to afford litigation expenses gain an opportunity to challenge unjustified IRS conduct.

Equally important to the remedial purpose underpinning section 7430 is the deterrent effect on unreasonable IRS behavior. Adopting the litigation position

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189. From February 28, 1983 through April 15, 1985; I.R.C. § 7430 yielded 20 awards totaling $140,734. *See Award of Attorneys Fees in Tax Cases: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. of Ways and Means*, 99th Cong., 1st Sess. 18 (April 25, 1985).

190. *See generally* Rowe, *The Legal Theory of Attorney Fee Shifting: A Critical Overview*, 1982 Duke L.J. 651, 653-66 (1982) (specific rationales to justify fee-shifting include fairness and indemnity, compensation for legal injury, punitive fee-shifting, private attorney general theory, effect on the parties' relative strengths, and general economic incentives).

191. Moats v. United States, 576 F. Supp. 1537, 1541 (W.D. Mo. 1984).

192. *See* Note, *supra* note 149, at 1214.

193. *See* Moholland v. Schweiker, 546 F. Supp. 383, 386 (D.N.H. 1982) (the decision to pursue litigation "is made prior to the action, and therefore will not be swayed by the potential that the government might not comport itself with proper adversarial etiquette").

194. *See* Rowe, *supra* note 190, at 664.

195. *Id.*; *see also* DeConcini, *Equal Access to Justice*, 2:6 Fed. Atty. Fee Awards Rep. 3-4 (Oct. 1979) (in addition to balancing party strengths, fee-shifting themes include "making whole those who have been the victims of unreasonable government action," encouraging resistance to unreasonable government action, generating public law precedent, and deterring agencies from vexatious litigation).

196. *See* Note, *supra* note 29, at 154 n.5. ("The extensive resources and personnel of government agencies render the decisions of these bodies almost impervious to challenge by the common citizen unless that individual is benefited by statutory provisions which help to ensure each person a day in court for the adjudication of appropriate complaints.").

197. *Supra* note 189, at 63 ("[i]t was this wrong that Congress intended to make right").

198. *Id.*

theory insulates the IRS from fee awards and offers no incentive to act reasonably.[199] Rather than resolve disputes through negotiation and settlement, taxpayers are compelled to file complaints at the earliest opportunity. After forcing taxpayers to litigate, the IRS can concede and effectively minimize its exposure to damage awards. Such circumvention of section 7430 emasculates the purposes Congress articulated in enacting TEFRA.[200] The underlying action theory precludes such a result by refusing to ignore unreasonable IRS conduct at earlier stages.

Supporting the litigation position doctrine, the Department of Justice and IRS argue that limiting the review of reasonableness to the facts and arguments before the court will conserve judicial resources.[201] The IRS further contends it must assume a position in many cases before the taxpayer provides all available facts and documentation.[202] Pre-litigation proponents respond by providing a mediatory definition of "position" referring to the last agency position creating the right to seek legal redress.[203] This modified underlying action approach alleviates the problem of reviewing every regulatory decision and administrative memorandum placed in agency files.[204]

The Department of Justice has suggested that testing reasonableness in the context of the litigation position serves to encourage settlement.[205] Presumably, the government is more receptive to settlement when the issue of attorney's fees is presented in the case in chief.[206] Contrary evidence indicates the IRS engages in indirect intimidation to limit the taxpayer's use of section 7430.[207] According to the United States Attorney, the government refuses to negotiate a settlement absent the taxpayer's waiver of his right to move for fees under the Code.[208]

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199. *Id.* at 64; *see also* Natural Resources Defense Council v. U.S.E.P.A., 703 F.2d 700, 706-07 (3rd Cir. 1983) (limiting the focus to the government's litigation position "means that no matter how outrageously improper the agency action has been, and no matter how intransigently a wrong position has been maintained prior to the litigation, and no matter how often the same agency repeats the offending conduct, the statute has no application, so long as employees of the Justice Department act reasonably when they appear before the court").

200. *See supra* note 3 and accompanying text.

201. *See supra* note 189, at 30, 33 (statement by Glenn L. Archer, Jr., Assistant Attorney General, Tax Division, Department of Justice) ("The court has merely to look and review the facts and arguments that are made in the case before it, whereas if it had to consider the IRS's [sic] conduct which was not subject to the trial, it would, in effect, have to conduct another trial on that issue.").

202. *Id.* at 15, 19 (statement by Roscoe L. Egger, Jr., Commissioner of Internal Revenue).

203. *Id.* at 37, 40 (statement by Frank S. Swain, Chief Advocacy Counsel for Small Business Administration) ("look at what happened before the actual lawsuit, but with proper limits on discovery").

204. *See id.* at 37.

205. *Id.* at 30-31.

206. *Id.* at 33 (statement by Glenn L. Archer, Jr., Assistant Attorney General, Tax Division, Department of Justice) ("Obviously the government will be more likely to settle a case if it can dispose of the case without having to litigate the merits in an attorney's fee proceeding.").

207. *Id.* at 64-65.

208. *Id.*

Section 7430 contains a sunset provision mandating its expiration on December 31, 1985.[209] Senator Baucus has introduced a bill which prolongs the section's existence and makes it applicable to the government's pre-litigation conduct.[210] Such a revision would be preferable to section 7430's extension absent a resolution of the dispute or its otherwise ineluctable termination. In the alternative, a modified underlying action approach defining "position" as including the final administrative posture would ultimately prove less objectionable.

## VI. Conclusion

A bureaucratic monolith such as the IRS should not be granted unbridled administrative authority in collecting federal tax revenue. When capricious government conduct forces a taxpayer into the legal system for redress, and the government subsequently concedes its position or the taxpayer substantially prevails, the taxpayer should be recompensed for his legal expenses. On balance, legislative adoption of the underlying action doctrine for section 7430 represents the most equitable and administratively feasible solution. Taxpayers victimized by the government's unreasonable conduct at any stage could be made whole by the award of reasonable litigation costs and attorney's fees. Agencies would be discouraged from engaging in vexatious administrative harassment. The IRS could no longer circumvent the statutory provision for fees by reversing its unwarranted conduct at the filing of the petition. Finally, economic considerations would effectively confine section 7430 motions to the few instances of truly outrageous IRS conduct.

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209. I.R.C. § 7430(f) (West Supp. 1985) provides: "(f) Termination—This section shall not apply to any proceeding commenced after December 31, 1985.

210. S. 1513, 99th Cong., 2d Sess. (1985) (the amendments provided in the bill include: removing the $25,000 limitation in favor of the EAJA limits on attorneys' hourly fees; replacing the "unreasonableness" standard with the "substantially justified" standard; mandating the standard be applicable to pre-litigation actions of government agents; and shifting the burden of proof from the taxpayer to the government).