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EARLELAW NEWSLETTER

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How to Make the IRS Pay Your Attorney Fees after an Audit

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“ “[A] party who chooses to litigate an issue against the Government is not only representing his or her own vested interest, but is also refining and formulating public policy.’ ” INS v. Jean, 496 U.S. 154, 165 n. 14 (quoting H.R. Rep. No. 96-1418, at 10 (1980)). For this reason, our legal system has adapted to ensure that, in certain circumstances, every citizen is able to defend himself against unjustified government action, free from the financial disincentives associated with litigation. [26 U.S.C. § 7430] provides such assurance to taxpayers.” Morrison v. Commissioner of Internal Revenue, 2009 WL 1312855 (C.A.9).

“The U.S. Tax Code permits a discretionary award of litigation costs, including attorneys’ fees, to the prevailing party in any civil tax proceeding brought by or against the United States. 26 U.S.C. § 7430(a). A ‘prevailing party’ is a party that ‘has substantially prevailed with respect to the amount in controversy’ or ‘with respect to the most significant issue or set of issues presented.’ § 7430(c)(4)(A)(i).” Id.

Section 7430 reads, in relevant part: “In any administrative or court proceeding which is brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, the prevailing party may be awarded a judgment or a settlement for . . . reasonable litigation costs incurred in connection with such court proceeding.”

The issue in Morrison was whether a taxpayer may recover attorney fees after successfully challenging an IRS audit where a third party, instead

of the taxpayer, advanced the taxpayer’s attorney fees to litigate against the IRS.

The fee controversy in Morrison arose after Morrison, a shareholder and officer in Caspian, a corporation, sold his interest in Caspian to Nariman Teymourian, another Caspian shareholder. Before Morrison resigned as an officer of Caspian, the IRS initiated audits of Morrison, Caspian, and Teymourian.

The IRS issued Notices of Deficiency to Morrison, Caspian and Teymourian. Morrison and Caspian each petitioned the United States Tax Court for redetermination; their tax court cases were consolidated and both parties retained the same law firm to represent them. After Morrison and Caspian both prevailed on their Tax Court petitions, both filed section 7430 motions seeking an award of attorney fees.

The Tax Court denied Morrison’s fee request on the ground that Morrison had not actually paid or “incurred” such fees, as Caspian had advanced Morrison’s fees under an agreement requiring Morrison to reimburse Caspian in the event Morrison was successful in obtaining a fee order against the IRS.

The IRS argued that Morrison had not “incurred” any attorney fees within the meaning of section 7430, arguing that a contrary interpretation of the term “incurred” would give rise to the so-called “stand-in” litigant problem. A stand-in litigant is one who seeks an award of attorney fees and then passes those fees on to an ineligible litigant.

Morrison, on the other hand, argued that the problems associated with a stand-in litigant, although perhaps a justified concern in the context of fee motions under other statutes, are not present in section 7430 cases because, unlike other cases litigated against the Government, it is the IRS who, at least in the first instance, initiates tax cases through audit and Notice of Deficiency. Additionally, Morrison argued, denying fee motions in tax cases where a third party paid the taxpayer's attorney fees would provide the government with an incentive to deny meritorious claims, thereby requiring a taxpayer to litigate. Thus, the government could act unreasonably not only in its initial administrative proceedings, but also during litigation of the appeal, confident in the knowledge that it will not be ordered to pay the taxpayer's attorney fees.

On appeal, the Ninth Circuit Court of Appeals found Morrison's argument more consistent with legislative intent than the position advanced by the IRS, and held that a taxpayer can "incur" attorneys fees if the taxpayer assumes either: (1) a noncontingent obligation to repay the fees advanced on his behalf at some later time; or (2) a contingent obligation to repay the fees in the event of their eventual recovery. *Id.*, at 3.

Because the Tax Court took the view that a litigant can never "incur" fees if the fees are first paid by a third party, the Tax Court did not reach the issue of whether the agreement between Caspian and Morrison would support an award of attorney fees in this case. Accordingly, the Ninth Circuit remanded the case to the Tax Court for further proceedings.

Please contact Earle Law Offices immediately to obtain ethical, aggressive tax controversy representation if you become the target of an IRS examination. Depending on the facts of your case, it may be possible to use section 7430 to obtain a fee award against the IRS. If Earle Law Offices prepared the return which is being audited, your attorney fees for tax controversy representation were included in the fee for the preparation of your return.

* Anthony F. Earle, Esq. practices in the areas of business law, family law, real estate law, tax law and trusts and estates; he represents individuals, small businesses, and real estate investors and professionals in both litigation and non-litigation matters.

Mr. Earle is licensed to practice law in all California state trial and appellate courts, the United States Supreme Court,

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