NEWS AND ANALYSIS

The Proof (and Presumptions And Experts) Is in the Primer

by Marie Sapirie

Evidentiary issues in Tax Court cases tend to be overshadowed by the substantive legal questions at stake, but a newly revised primer reminds practitioners that careful attention to procedural details matters in developing the substantive law and winning the case.

The second edition of *A Practitioner’s Guide to Tax Evidence* by Joni Larson is a helpful guide to navigating evidentiary issues in Tax Court cases. It walks readers sequentially through the Federal Rules of Evidence and explains how they have been applied in Tax Court cases, with plenty of examples that will prove valuable to litigators preparing for trial. With something on the order of 20,000 to 30,000 cases docketed in the Tax Court each year and the application of the Federal Rules of Evidence to cases in which the amount in controversy is greater than $50,000, this manual on evidentiary issues has broad relevance.

Section 7453

The Protecting Americans From Tax Hikes (PATH) Act of 2015 made a sensible change to section 7453 that essentially conformed the statute to what had been happening all along, as Larson noted in a 2016 Procedurally Taxing blog post and expanded on in *Tax Evidence*. Instead of requiring the Tax Court to follow the rules of evidence applicable in trials without a jury in the U.S. District Court of the District of Columbia, the PATH Act ensures that the Tax Court follows the Federal Rules of Evidence. That legislative change means the court applies the evidentiary precedent of the circuit courts of appeals to cases in which the amount in controversy is greater than $50,000, this manual on evidentiary issues has broad relevance. *Tax Evidence* also includes a useful update to the 2011 revision of the Federal Rules of Evidence and highlights important Tax Court rules about evidentiary issues.

The new edition of *Tax Evidence* helps practitioners navigate that change by noting circuit splits on Federal Rules of Evidence interpretations and illustrating those differences in charts. For example, four circuit courts of appeal maintain that Rule 106 regarding the introduction of the omitted portion of a writing or recording does not compel admission of otherwise inadmissible hearsay evidence, and four, including the D.C. Circuit, maintain that the rule does require admission of some otherwise inadmissible evidence. Similarly, Rule 301 on presumptions has generated controversy in the circuits over whether inadmissible evidence may serve as the basis for a statutory notice of deficiency when the IRS determines that the taxpayer had unreported income. The IRS must link the taxpayer to unreported income with sufficient evidence. The Second Circuit has held that a statutory notice of deficiency based on inadmissible evidence is arbitrary and that the notice is not entitled to the presumption of correctness, but three other circuits would consider inadmissible evidence in determining whether the IRS met its burden of proof.

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When the Tax Court revised its own Rule 143 on evidence in response to the PATH Act, the American Bar Association asked the Tax Court to clarify what happens when prior Federal Rules of Evidence interpretations by the Tax Court and the appellate court to which the case would be appealed are in conflict, a question that does not yet seem to have a definitive answer.

**Recent Case Law**

Although many fundamental evidentiary questions have been resolved (*Tax Evidence* provides all the relevant citations to the well-established interpretations), the Tax Court’s jurisprudence continues to evolve, and *Tax Evidence* reviews recent developments, including
two cases regarding the relevance of evidence. In *Whistleblower 11099-13W v. Commissioner*, 147 T.C. 110 (2016), the court addressed a discovery request by the taxpayer and noted that “relevant” is defined more narrowly under Federal Rule of Evidence 401 than under Tax Court Rule 70(b). The IRS didn’t distinguish between whether the information requested by the whistleblower was material or probative, and the Tax Court granted the discovery request.

*Finnegan v. Commissioner*, T.C. Memo. 2016-118, receives more attention in the revised edition because in determining that the returns at issue in the case were prepared fraudulently, the Tax Court considered several evidentiary issues such as Rule 403 regarding cumulative evidence and Rule 406 on a person’s habit or routine practice. The IRS offered evidence to prove that when the preparer prepared fraudulent returns, he routinely used specific entries and methods that also appeared on the taxpayer’s returns. The taxpayer tried to refute the relevance of the evidence, but the Tax Court accepted the evidence on the ground that “whether Mr. Howell had a habit or routine when fraudulently preparing returns and whether petitioners’ returns display elements of that habit or routine are facts of consequence making it more or less probable that Mr. Howell prepared petitioners’ returns falsely or fraudulently with the intent to evade tax.”

Expert testimony is a recurring theme in Tax Court litigation, particularly in valuation cases involving charitable donations of easements and other property disputes. If Congress eventually adopts a broad mark-to-market regime, new valuation questions could put even more pressure on expert testimony. Accordingly, *Tax Evidence* outlines the requirements for qualifying witnesses as experts and for the components of their testimony and provides a roadmap for evaluating expert reports based on recent cases. For example, experts must disclose their methods and rely on sufficient facts for the court to consider their testimony useful in understanding the evidence or determining a fact at issue.

Experts still occasionally try to include legal conclusions in their reports, which renders any relevant portions impermissible. In *Weintraut v. Commissioner*, T.C. Memo. 2016-142, the court excluded some conclusions of the IRS’s expert regarding whether a stock sale was in substance a distribution of cash to shareholders because they depended on legal analysis. The Tax Court has recently seemed inclined to have opposing experts testify concurrently in a dialogue with the judge, a practice that merits attention in witness preparation. Larson refers to cases and an article that could help in that process.

In the appendix, Larson includes a summary of the most commonly used rules of evidence. That checklist, along with the practice pointers throughout the book and the detailed table of contents, enhances the practical utility of the primer as a reference work and seems likely to help reassure practitioners preparing for a Tax Court trial that they will not have overlooked an important facet of the evidentiary rules.