I.R.C. Section 7430 Attorney’s Fees: Navigating Section 7430 and a Call for the Final Act

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ABSTRACT

This Article analyzes section 7430 of the Internal Revenue Code as amended by the Internal Revenue Service Restructuring and Reform Act of 1998. Specifically, the Article discusses from a tax policy standpoint whether the statute adequately expands prevailing taxpayers’ rights to recover reasonable litigation and administrative costs from the Internal Revenue Service. Consistent with academic studies of previous section 7430 amendments, the Article suggests that the current statute fails to provide taxpayers the remedies needed to deter the IRS from pursuing issues or positions that are not substantially justified. The authors conclude that Congress must further amend section 7430.

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Internal Revenue Code § 7430 authorizes the IRS and federal courts to award attorneys' fees to taxpayers who prevail against the United States when the IRS fails to establish that its position in an administrative or court proceeding is substantially justified.\footnote{1} Although accurate, the foregoing description is misleading. It suggests recovering fees from the government is all but a formality once a taxpayer has defeated the United States in an administrative proceeding or litigation. In reality, upon prevailing against the United States, taxpayers requesting an award of attorneys' fees may learn that sometime between receipt of the 30-Day Letter and the conclusion of the proceeding the taxpayer inadvertently failed to comply with just one of 7430's numerous procedural requirements and is now ineligible for an award of fees. Should the taxpayer successfully navigate 7430's procedural obstacle course, the taxpayer may nonetheless be disqualified from an award of attorneys' fees and costs for reasons inconsistent with the purpose of the statute; or the taxpayer may learn that 7430 reduces "substantially justified" to a mere term of art, or that 7430's cap on the attorney's rate used for calculating an award of fees is but a fraction of the rate the taxpayer paid his sophisticated tax attorney.\footnote{2}

Despite section 7430's shortcomings, Congress was nonetheless well-intentioned in enacting section 7430 "to deter abusive actions or overreaching by the [IRS] and to enable taxpayers to vindicate their rights regardless of their economic circumstances."\footnote{3} And although 7430 is a radical departure from the dark days governed by sovereign immunity\footnote{4} and the American Rule,\footnote{5} in practice 7430 falls far short of

\footnotesize{1. I.R.C. § 7430(a) (2000).
2. Id.
4. The doctrine of sovereign immunity instructs that the United States may not be sued, nor its funds expended, without explicit congressional authorization.
5. Generally, the "American Rule" provides that each party must bear its own legal expenses. See Gregory C. Sisk, A Primer on the Awards of Attorney's Fees Against the Federal Government, 25 Ariz. St. L.J. 733, 738-40 (1993) (citing cases and}
serving as the check on the IRS that it is purported to be.

This Article will provide history and context for analyzing the current section 7430. This Article also provides guidance to taxpayers and their advisors navigating current section 7430's procedural requirements while also (i) identifying those instances where section 7430 fails to implement congressional intent and (ii) proposing remedial legislation.

II. THE HISTORY OF ATTORNEYS’ FEES AWARDS AGAINST THE UNITED STATES IN TAX LITIGATION

The doctrine of sovereign immunity and the American Rule, which provides that “the prevailing litigant is ordinarily not entitled to collect a reasonable attorneys’ fee from the loser,” had traditionally combined to prevent American taxpayers from recovering attorneys’ fees from the Internal Revenue Service. Congress began limiting the United States government’s sovereign immunity in 1972 by amending the Civil Rights Act of 1964 to permit fee awards against the United States in limited circumstances. In 1980, Congress marked an unprecedented departure from notions of governmental impunity by enacting the Equal Access to Justice Act (“EAJA”). The EAJA made the United States susceptible to fee awards under common law theories and in all civil actions brought by or against the United States. There were two exceptions, however: most torts and tax cases.

The Civil Rights Act of 1964, the Civil Rights Attorney’s Fees Act of 1976 and the EAJA initiated what has become the American legal system’s broadening embrace of fee-shifting to the detriment of the United States government. Congress has incrementally increased the availability of attorneys’ fees against the federal government through various statutes. See, e.g., The Civil Rights Act of 1964, 42 U.S.C. § 2000(e)-5 (1972) (permitting the award of attorneys’ fees against the government and amended in 1991 to expressly waive the government’s sovereign immunity); see also The Americans With Disabilities Act of 1990, 42 U.S.C. § 12205

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1976, and then the EAJA, only authorized awards of attorneys' fees in tax litigation in federal district courts and the Court of Federal Claims, which host only a nominal portion of tax litigation. Despite such restrictions, the EAJA undoubtedly motivated Congress to allow awards of attorneys' fees to tax litigants who prevail against the United States in court. With the 1982 enactment of the Tax Equity and Fiscal Responsibility Act (TEFRA), Congress expanded attorneys' fee awards to tax litigation in all federal courts. TEFRA specifically granted the Tax Court statutory authority to award attorneys' fees by introducing Internal Revenue Code § 7430. Section 7430 now authorizes both the Internal Revenue Service and federal courts to award attorneys' fees, administrative costs and litigation costs to prevailing parties (other than the federal government) in tax-related litigation.


11. See McQuiston v. Comm' r, 78 T.C. 807, 811-12 (1982) (holding that neither the EAJA nor the Civil Rights Attorney's Fees Award Act of 1976 authorize the Tax Court to award attorneys' fees).


15. Congress amended section 7430 eight times following its enactment in 1982. The most recent amendment was in 2000.
prevailing tax litigants. Most notably: tax practitioners\textsuperscript{16} were generally unfamiliar with the statute; the law included complex timing deadlines; onerous procedural requirements favoring the IRS; courts were uncertain as to whether pro se attorneys were entitled to receive fees;\textsuperscript{17} there was no provision permitting compensation for pro bono services; and there was a nominal, hourly-rate cap on attorneys' fees awards.\textsuperscript{18}

In response to common public perception of the IRS as a purveyor of fear and intimidation, Congress enacted the Internal Revenue Service Restructuring and Reform Act of 1998 ("Reform Act").\textsuperscript{19} The Reform Act was an effort to recast the IRS as a customer service oriented governmental agency and infuse the perception of fairness into the tax collection process. It did so by equipping taxpayers with additional rights and remedies.\textsuperscript{20} The Reform Act made several significant pro-taxpayer modifications to section 7430,\textsuperscript{21} including:

\textsuperscript{16} 31 C.F.R. § 10.3 (2009) (The term "tax practitioners" is defined in Treasury Department Circular No. 230 to include, accountants, lawyers, enrolled agents and enrolled actuaries who are admitted to practice before both the Internal Revenue Service and Tax Court).

\textsuperscript{17} Brett Barenholtz, \textit{Fees for the Taxpaying Fool: I.R.C. section 7430 Fee Awards to Pro Se Attorneys}, 38 CASE W. RES. 408, 422 (1988).

Judicial opinions provide significant authority in evaluating section 7430 and the validity of pro se attorney fee awards. Since both the Frisch and McPherson cases involve matters of first impression for their respective courts, no binding precedent exists. However, other cases do exist which address pertinent aspects of awarding pro se attorney fees. First, there are cases that apply other statutory fee award provisions. Some award fees to pro se attorneys, while others deny them. Still other cases that do not involve pro se attorneys offer general guidelines. Second, there are cases that apply section 7430 in other contexts. A review of pertinent case law provides numerous guidelines and extensive consideration of the issues.

\textit{Id.}


\textsuperscript{20} Wm. Brian Henning, \textit{Reforming the IRS: The Effectiveness of the Internal Revenue Service Restructuring and Reform Act of 1998}, 82 MARQ. L. REV. 405, 405-06 (1999) ("The Reform Act purports to comprehensively reform the IRS, making it more user-friendly and more accountable to taxpayers. Additionally, the Reform Act is intended to enhance the fairness of the tax collection process, solve the problems created by the complicated code, and restore public confidence in the way the IRS enforces the code.").

\textsuperscript{21} The Department of the Treasury issued proposed treasury regulations on November 25, 2009 to conform the section 7430 regulations to the Taxpayer Relief Act
(i) providing for recovery of reasonable administrative costs retroactive to the first letter of proposed deficiency (30-day letter) that permitted the taxpayer an opportunity for administrative review with the IRS Appeals Office;\textsuperscript{22}

(ii) raising the hourly rate cap to the amount provided in the EAJA;\textsuperscript{23}

(iii) expanding the circumstances authorizing awards to exceed the hourly rate cap;\textsuperscript{24}

(iv) considering IRS defeats in other judicial circuits as a factor relevant to determining whether the IRS position is substantially justified;\textsuperscript{25}

(v) allowing \textit{pro bono} representatives to recover fees;\textsuperscript{26} and

(vi) imposing a rule awarding litigation and administrative costs when the IRS rejects a taxpayer’s qualified offer but later recovers less than the taxpayer’s offer.\textsuperscript{27}

Although the Reform Act remarkably broadened taxpayers’ rights under section 7430, the Act and subsequent amendments to 7430 remain short of amounting to the deterrent to IRS abusive practices and overreaching that Congress intended. This Article simplifies 7430’s complex procedural requirements. In doing so, the following discussion will illustrate that Congress should revisit section 7430 once more. Congress should align the IRS’s incentives to contest the awards of attorneys’ fees and litigation costs with the merits of a particular claim.

III. THE IRS EXAMINATION PROCESS

Before analyzing post-Reform Act section 7430 in further detail, a concise review of the relevant administrative and judicial process for resolving tax controversies follows.

\textsuperscript{22} I.R.C. \textsection 7430(c)(2)(B) (2006).
\textsuperscript{24} I.R.C. \textsection 7430(c)(1)(B)(iii).
\textsuperscript{25} \textit{Id.} \textsection 7430(c)(4)(B)(iii).
\textsuperscript{26} \textit{Id.} \textsection 7430(c)(3)(B).
\textsuperscript{27} \textit{Id.} \textsection 7430(c)(4)(E).
A. The IRS Examination and 30-Day Letter

The Internal Revenue Service conducts tax return examinations either by a correspondence examination, office audit, or field examination. Its chosen method(s) vary depending on the issues and the type of taxpayer involved. If the IRS examination proposes changes to the taxpayer’s return, the examining agent will prepare a “revenue agent’s report” containing the agent’s findings and the respective positions of the taxpayer and the IRS. The IRS then sends the report with a transmittal letter to the taxpayer stating that the taxpayer has 30 days within which to notify the IRS whether the taxpayer will accept or appeal the proposed adjustments set forth in the report. The letter, and the accompanying report, are commonly referred to as the “30-day letter.”

The letter informs the taxpayer of their right to challenge the proposed adjustments, describes the taxpayer’s appeal rights and grants the taxpayer 30 days within which to protest the IRS determination and request a hearing (i.e., conference) before the IRS Appeals Office. The taxpayer may request a hearing orally or in writing, depending on the type of examination involved and the total amount of proposed tax, proposed over-assessment, claimed refund or, if an offer in compromise, the total amount contested.

B. IRS Appeals Office Conference

Taxpayers may, but are not required to request an administrative hearing with the IRS Appeals Office. The Appeals Office is separate and independent of the IRS examination function. It is the only level of appeal within the IRS. Generally, Appeals Office conferences are conducted informally. The taxpayer or his representative meet with the IRS appeals officer to exchange information and documents, and discuss the disputed issues without complying with formal rules of evidence or

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28. See Kevin E. Murphy & Mark HiggenS, Concepts in Federal Taxation 24 (16th ed. 2009) (Although the Internal Revenue Service issues different types of 30-day letters, Letter 525 is presently the “general” 30-day letter the IRS sends taxpayers).

29. See Treas. Reg. § 601.105(c)(1)(i) & (ii) (as amended in 1987) (permitting an Appeals Office conference upon the taxpayer’s request without the submission of a formal written request after a correspondence or office examination).

30. See id. § 601.105(c)(2) (providing that after a field examination a written request is not required unless the amount in controversy exceeds $2,500, in which case a brief written statement of the issues disputed is required. If the amount exceeds $10,000, a formal written protest is required.).
judicial procedure. The appeals officer has the authority to settle all issues of fact and law, and most importantly, to settle the case based on the "hazards of litigation." Whether a taxpayer decides to request an appeal depends upon a variety of factors such as the continued deferral of taxes, taxpayer liquidity issues, the informality of the proceedings, and the costs and expenses associated with litigation.

If the taxpayer does not request an administrative appeal, the taxpayer will not be deemed to have exhausted all administrative remedies as required to recover fees and costs under section 7430.

C. Tax Disputes in Judicial Proceedings

If the taxpayer either fails to file a protest and request an Appeals Office hearing, or is unable or unwilling to settle the case with the Appeals Office, the IRS will issue a notice of deficiency to the taxpayer. The taxpayer has two options if the IRS issues a notice of deficiency. The taxpayer, within 90 days from the date that the IRS issues the notice of deficiency, either may pay the contested tax and file a claim for refund, or file a petition with the Tax Court.

If the taxpayer pays the tax and files a claim for refund, the IRS may grant or deny the claim in whole or in part. If the IRS denies the claim for refund, or does not act upon the claim for refund within six months from the filing of the claim, the taxpayer may file suit for a tax

31. I.R.C. § 6212 (2006). If the IRS determines there is a deficiency of income, estate, gift, or certain miscellaneous excise taxes, the law authorizes the IRS to send a notice of such deficiency to the taxpayer by certified or registered mail. The notice of deficiency is not an assessment of tax. Rather, it is a proposed deficiency and gives the taxpayer 90 days (150 days if the notice is mailed to an address outside the United States) to either agree to the deficiency or file a petition with the United States Tax Court for a redetermination of the deficiency, but once the notice of deficiency is issued, the 90- or 150-day period cannot be suspended or extended. See id. § 6213(a). The notice of deficiency can be rescinded under certain circumstances if both parties agree. See id. § 6212. The notice of deficiency is also known as the "90-day letter."

32. I.R.C. § 6213 (2006). The taxpayer, of course, may do nothing. In that case, the IRS will assess the additional tax liability set forth in the notice of deficiency. The taxpayer would still have the option of paying the tax assessed, however, and filing a claim for refund.

33. Id. The Reform Act requires the IRS to include on each notice of deficiency the actual date by which the taxpayer must file such a petition. Any petition filed on or before the date specified is considered timely. This change is applicable to all notices of deficiency mailed after December 31, 1998.

34. Id.
refund in either the United States District Court or the U.S. Court of Federal Claims. The conduct of tax proceedings before the U.S. Tax Court, United States District Court, and the U.S. Court of Federal Claims is pursuant to the Federal Rules of Evidence and Rules of Practice and Procedure of each court.

IV. SECTION 7430 AND THE REFORM ACT’S EXPANSION

4. Analysis of section 7430

(1) Generally

Section 7430 authorizes the award of reasonable litigation and administrative costs, including attorneys’ fees, reasonable expert witness fees, and other costs incurred “in connection with the determination, collection, or refund of any tax, interest, or penalty . . .” under the Internal Revenue Code. Attorneys’ fees claimed by non-lawyers are permitted if the individuals are authorized to practice before the IRS, but their fees are subject to the same limitations as those imposed upon attorneys’ fee awards.

(2) Who is the “Prevailing Party”?

The determination that the taxpayer is the “prevailing party” in a dispute with the IRS is essential for the taxpayer to be awarded

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36. Id. § 7430(a)(1).
37. Id. § 7430(a).
38. Id.
39. See id. § 7430(c)(3)(A) (providing that “attorneys’ fees” includes fees for the services of an individual—whether or not an attorney—who is authorized to practice before either the Tax Court or the IRS); see also IRS Litigation Guideline Memorandum TL-12 (Rev.), In re Litigation and Administrative Costs Awards under I.R.C. § 7430 (Dec. 14, 1990) (stating that litigation costs for services provided by individuals not admitted to practice before the Tax Court may be recovered under only three circumstances: (1) the individual works for or at the direction of a person who is admitted to practice before the Tax Court; (2) the individual is an expert witness; or (3) the individual engages in any study, analysis, engineering report, test or project that is necessary for the preparation of the case).
attorneys' fees.\textsuperscript{40} A prevailing party\textsuperscript{41} is any party to a proceeding to which section 7430 applies that "has substantially prevailed with regard to the amount in controversy," or "with respect to the most significant issues or set of issues presented."\textsuperscript{42}

The determination of whether a party is a "prevailing party" with respect to the "amount in controversy"\textsuperscript{43} is made by agreement between the parties, or where a final determination is made by a court, then the court makes the determination.\textsuperscript{44} The IRS determines which party is the prevailing party when disputes are resolved at the administrative level.\textsuperscript{45} Taxpayers are permitted to appeal the IRS decision to grant or deny attorney fees and administrative costs by filing a petition for review with the Tax Court.\textsuperscript{46} Although the IRS may unilaterally award attorneys' fees in a proceeding to which it is a party at the administrative level, the Tax Court is the ultimate authority as to whether the IRS is the prevailing party at the administrative level.

A taxpayer may be the prevailing party as to: (a) the amount in controversy; (b) the most significant issue or set of issues in the case; or (c) both. If the taxpayer does not substantially prevail as to the amount in controversy, the taxpayer may still qualify as a prevailing party if he substantially prevails on the most significant issue or set of issues presented.\textsuperscript{47} Although permitting taxpayers to recover on either basis enhances the likelihood of the taxpayer's recovering attorney's fees, the court's determination as to which issue is the most significant is subjective. Nonetheless, treasury regulations promulgated under section 7430 explain that an issue or set of issues means the most significant issue, or set of issues, presented. Each issue's impact by dollar amount, relative to the amount contested in the preceding, is an objective means of determining the most significant issue or set of issues before the

\begin{itemize}
\item \textsuperscript{40} I.R.C. § 7430(a) (2006).
\item \textsuperscript{41} See id. § 7430(c)(4)(A) (expressly excluding the United States and creditors from the definition of "prevailing party").
\item \textsuperscript{42} Id. § 7430(c)(4)(A)(i)(I).
\item \textsuperscript{43} See Treas. Reg. § 301.7430-5(d) (as amended in 1997) (providing that the amount in controversy is determined at the administrative proceeding and is increased by any amounts subsequently placed in issue by any party).
\item \textsuperscript{44} Id. § 301.7430-5(e).
\item \textsuperscript{45} I.R.C. § 7430(c)(4)(C)(ii) (2006).
\item \textsuperscript{46} Id. § 7430(f)(2); TAX CTR. 230-233.
\item \textsuperscript{47} Treas. Reg. § 301.7430-5(e) (as amended in 1997).
\end{itemize}
court. Differences in dollar amount by issue may occur when the resolution of an issue or set of issues impacts the taxpayer’s or related parties’ other transactions or taxable years.

A taxpayer will not be treated as the prevailing party, however, if:

(a) the government establishes that its position was “substantially justified;”
(b) the taxpayer fails to meet the statutory net worth requirement;
(c) the taxpayer does not exhaust its administrative remedies; or
(d) the taxpayer protracts the administrative or judicial proceedings.

Each of these exceptions to fee-shifting provisions is evaluated in turn.

(a) Is the Government Position "Substantially Justified"

A prevailing party will not be entitled to an award of administrative and litigation costs to the extent the government establishes that its position in administrative proceedings and litigation was “substantially justified.” The IRS generally asserts that its position will be substantially justified if it has a reasonable basis in both law and fact or is justified to a degree that could satisfy a reasonable person.

The IRS position is presumed to be without substantial justification if its position in the administrative proceeding is inconsistent with published guidance, including treasury regulations, revenue rulings, private letter rulings, revenue procedures, technical advice memoranda, information releases, or determination letters issued as to the specific taxpayer. An IRS concession of a case, however, does not constitute a

48. Id.
49. Id.
54. I.R.C. § 7430(c)(4)(B)(iv) (2006). H.R. REP. No. 104-506, at 37 (1996), provides that only the most current version of the enumerated IRS published guidance as determined at the date the IRS position was taken will be considered for the purposes of this rule. Treas. Reg. § 301.7430-5(h) (as amended in 1997), Example 1, provides that for each cost for which the taxpayer seeks an award, the question of substantial justification is determined as of the date the cost was incurred.
finding that its position was not justified.\textsuperscript{55}

To prevent the IRS practice of manufacturing substantial justification by "circuit shopping," the Reform Act included a new provision\textsuperscript{56} that expressly instructs courts to consider whether the United States has lost on substantially similar issues in other judicial circuits when determining whether the position of the United States was substantially justified.\textsuperscript{57} Several appellate courts have provided instructions for determining when an IRS position is or was substantially justified. The Eighth Circuit emphasized that the determination as to whether the IRS position is substantially justified is a case-by-case, facts-and-circumstances determination.\textsuperscript{58} Another court suggested that a position is substantially justified if the justification for the position could satisfy a reasonable person.\textsuperscript{59} A Tax Court memorandum opinion instructed that the IRS position is judged based on whether it was reasonable in light of its "legal and factual moorings."\textsuperscript{60} The Fourth Circuit held in determining whether the Service’s position is substantially justified, that the "mistakenness" of the determination should not be confused with the "reasonableness" of the determination.\textsuperscript{61}

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\item See, e.g., TSA/Stanford Assoc., Inc. v. Comm’r, 77 F.3d 490 (9th Cir. 1996) (holding the IRS concession did not automatically warrant attorneys’ fees, and the IRS position was not substantially \textit{unjustified} when (i) it conceded significant substantive issues and (ii) three of four trial court decisions contrary to the IRS position were on appeal during the deficiency proceeding, and the fourth was decided less than a month prior to the IRS’s concession, and one court of appeals held in favor of the IRS on the issue).
\item In applying the new rule enacted by the Reform Act, a New York Federal District Court held that where the Service ignored a precedent from another circuit seeking to gain a split amongst the circuits and to create an appellate vehicle, the IRS position was not substantially justified. See Gateway Equip. Corp. v. United States, 247 F. Supp. 2d 299 (W.D.N.Y. 2003). See also Allbrittone v. Comm., 37 F.3d 183 (5th Cir. 1994) (Prior to the 1998 amendment, the Fifth Circuit invited taxpayers to file an application upon their own initiative when considering the question of substantial justification. The court reasoned the IRS’ actions constituted no more than “circuit shopping.”).
\item See Kenagy v. United States, 942 F.2d 459 (8th Cir. 1991) (providing examples of circumstances which might result in a determination that the IRS’s position might not be reasonable such as the failure to adequately investigate its case, or placing unwarranted reliance on biased witnesses).
\item Info. Res., Inc. v. United States, 996 F.2d 780 (5th Cir. 1993).
\item Guyan Oil Co. v. Comm’r, 56 T.C.M. (CCH) 433 (1988).
\item United States v. Little, 104 F.3d 360 (4th Cir. 1996).
\end{enumerate}
\end{footnotesize}
The Tenth Circuit, in affirming the Tax Court, appeared to give greater latitude to the IRS by stating that its position may be substantially justified, yet be *capricious, arbitrary and without sound basis in fact*.\(^{62}\) Considering the foregoing rulings, neither Congress nor the federal courts have offered a bright-line test for determining whether the IRS position is substantially justified. But one thing is certain—the prevailing party will not be entitled to an award of administrative and litigation costs associated with those issues if the court determines the IRS position is substantially justified.\(^{63}\)

As the foregoing indicates, the moment at which the government established its position is significant. When measuring section 7430 *litigation costs*, the “position of the United States” is the government’s position stated in its answer to the taxpayer’s petition filed in court.\(^{64}\) The government’s position as to *administrative costs* is the IRS position determined on the earlier of (a) the date that the taxpayer receives a notice of decision from the IRS Appeals Office,\(^{65}\) or (b) the date of the notice of deficiency.\(^{66}\) Section 7430 grants the IRS substantial latitude to change its section 7430 position. In fact, section 7430 does not impose any requirement that the government’s position bear even a remote resemblance to the IRS position in the 30-day letter.

The practical result is that if the IRS determines that it made an error or that its theory challenging the taxpayer’s position is weak at the administrative level, the IRS may simply refrain from taking a position. For instance, when the diligent taxpayer resolves a tax dispute with the IRS at the administrative level, i.e. following the IRS’ issuance of a claim disallowance letter, the IRS does not issue a notice of deficiency nor is the IRS required to take a position. As the Tax Court explains in a 2007 Tax Court Memorandum, taxpayers who do a good job at the administrative level of resolving issues and getting the [Internal Revenue Service] to realize the error of [its] ways are precluded from recovering administrative costs incurred in achieving those favorable results. To the contrary, taxpayers who do


\(^{63}\) *Id.* Note, however, that whether the government’s positions in the administrative and litigation proceedings were substantially justified is not relevant for an award under the qualified offer rule.


\(^{65}\) *Id.* § 7430(c)(7)(B)(i).

\(^{66}\) *Id.* § 7430(c)(7)(B)(ii).
not do as good a job at the administrative level and who receive adverse Appeals Office notices of decision or notices of deficiency, but who later convince respondent to concede issues or who substantially prevail in litigation on the issues, are able to seek a recovery of administrative costs. In effect, taxpayers who do a better job at the administrative level of resolving issues raised by respondent on audit are prejudiced in their ability to recover administrative costs under section 7430.67

As the Tax Court’s reasoning demonstrates, Congress’ narrow drafting of section 7430 undermines Congress’ statutory intent by punishing taxpayers who were subject to improper IRS conduct, but who diligently, effectively and efficiently resolved their dispute with the IRS, and section 7430 thereby permits the IRS a back door out of any obligation to pay attorneys’ fees to the taxpayer.

The Reform Act’s congressional history indicates that Congress elected not to determine the IRS position at the issuance of the 30-day letter.68 By foregoing the opportunity to put some teeth into section 7430 with the Reform Act, Congress’ decision not to do so demonstrated a lack of understanding or lack of commitment to section 7430’s guiding principle “to deter abusive actions and overreaching by the [IRS] and to enable taxpayers to vindicate their rights regardless of their economic circumstances.”69

67. Kwestel v. Comm’r, 93 T.C.M. (CCH) 1288 (2007). Under the narrow statutory language of section 7430(c)(7) as written, under respondent’s interpretative regulation under section 7430 . . . and under the interpretation placed thereon by the referenced court cases, taxpayers (such as petitioners herein) who do a good job at the administrative level of resolving issues and getting respondent to realize the error of his ways are precluded from recovering administrative costs incurred in achieving those favorable results. To the contrary, taxpayers who do not do as good a job at the administrative level and who receive adverse Appeals Office notices of decision or notices of deficiency, but who later convince respondent to concede issues or who substantially prevail in litigation on the issues, are able to seek a recovery of administrative costs. In effect, taxpayers who do a better job at the administrative level of resolving issues raised by respondent on audit are prejudiced in their ability to recover administrative costs under section 7430.

Id.

68. Florida Country Clubs, Inc. v. Comm’r, 122 T.C. 73, 84 (2004). The first factor we rely upon to find that Congress specifically rejected adding the 30-day letter to the definition of “position” in section 7430 is that Congress failed to amend subsection (c)(7) in RRA 1998 even though Congress amended subsection (c)(2) to include within the definition of “reasonable administrative costs” those costs incurred on or after the date on which the 30-day letter is sent.

Id.

69. Cooper v. United States, 60 F.3d 1529, 1530 (11th Cir. 1995) (quoting Weiss v.
Because section 7430 permits the IRS to take different positions at the administrative level and the judicial level, the presiding court may consider each position separately to determine whether each is substantially justified. Therefore, the IRS may assert one position in its notice of deficiency and then assert a different position in its answer to the taxpayer’s Tax Court petition or claim for refund. But, in Tax Court, to the extent the IRS raises new issues, increases the asserted deficiency or raises affirmative defenses in the Service’s answer, the IRS bears the burden of proof. Section 7430’s regulations also permit the IRS position to be substantially justified “in part” with respect to certain issues, or a with respect to a “portion” of the proceedings and not to another part or portion. The ability of the IRS to change its position at various stages of a taxpayer controversy diminishes section 7430’s utility to taxpayers and weakens Congress’ intended purpose of preventing IRS overreaching and encouraging settlement.

Although section 7430’s substantial justification standard requires revisions to align it with Congress’ statutory intent to curb improper practices and positions by the IRS, the Reform Act’s shifting of the burden of proof regarding substantial justification was a significant taxpayer friendly change. However, section 7430’s substantial justification standard requires revisions to align it with Congress’
statutory interest to curb improper practices and positions by the IRS. As discussed above, section 7430 currently requires the IRS to prove that its position is substantially justified to avoid an award of fees to the taxpayer. However, prior to the Reform Act, taxpayers were saddled with the burden of proving that the IRS’ position was not substantially justified; and prior to the 1986 amendments to section 7430, taxpayers were required to satisfy an even more onerous standard—that the IRS position was “unreasonable.”

(b) Affluent Taxpayers Need Not Apply—
section 7430’s Net Worth Requirement

Section 7430 conditions a taxpayer’s qualification as a prevailing party on the taxpayer satisfying a statutory net worth requirement. Section 7430 contains the same net worth requirements as the EAJA. Administrative and litigation costs awards are unavailable to an individual or estate when their net worth exceeds $2,000,000; corporations, partnerships, or unincorporated businesses whose net


Prior to the 1986 amendments, in order to be eligible for reimbursement of fees under section 7430, a taxpayer had to establish that the government’s position was unreasonable. In contrast, under the amended provisions, the taxpayer must show only that the government’s position was not “substantially justified.” One might assume that there is little difference between the two standards. After all, each phrase can be defined in terms of the other: a reasonable position is one that is substantially justified; a substantially justified position is a reasonable one . . . . Despite these similarities, there may be a small difference in meaning between the two terms. There may be cases in which it would be reasonable to proceed with a position that has some justification, though that justification might not rise to a level where it could be said to be substantial . . . . Several courts have held correctly that “substantial justification” means more than merely reasonable . . . .

Id.; see also James A. McQueen, Tax Litigation and Attorney’s Fees: Still A Win-Lose Dichotomy, 57 S. CAL. L. REV. 471, 471-84 (1984).

While section 7430 may appear to signal a movement away from the rejection by the American Rule of fee shifting between litigants, the section is more in accord with the American Rule than it may seem, for it will in fact only rarely result in the awarding of attorney’s fees . . . . The main obstacle taxpayers face in order to recover attorney’s fees is establishing that “the position of the United States was . . . unreasonable.

Id.


77. See id. § 7430(c)(4)(A) (cross-referencing the net worth requirements of 28 U.S.C. § 2412(d), a provision of the Equal Access to Justice Act).
worth exceeds $7,000,000; and businesses employing more than 500 employees, regardless of the net worth of that business. Individuals who file a joint return are treated as separate individuals for the purposes of the net worth requirement. The result of this rule is a net worth limitation of $4,000,000 for individuals who file a joint return, or $2,000,000 per taxpayer. When a taxpayer's net worth exceeds the statutory thresholds, the taxpayer is also disqualified from being deemed a prevailing party under the qualified offer rules discussed in greater detail below.

Charitable organizations are exempt from section 7430's net worth limitations. Charitable organizations are not, however, exempt from the employee limitation. Thus, charitable organizations with more than 500 employees are not eligible for awards of attorneys' fees. Section 7430's net worth provisions, like several other section 7430 provisions, are incongruent with the purpose of protecting taxpayers from IRS overreaching. Section 7430 ignores that pursuing "test cases" against high net worth taxpayers is often more cost effective for the IRS than challenging positions taken by taxpayers to whom section 7430's protections would be available. Nonetheless, when the incentive for capricious IRS challenges to taxpayer positions is greatest, section 7430 leaves high net worth taxpayers defenseless against improper IRS pursuits.

(c) "Exhausting" Administrative Remedies

Section 7430 also requires taxpayers to exhaust all available administrative remedies within the Internal Revenue Service to qualify

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78. Id. § 7430(c)(4)(D)(i); Treas. Reg. § 301.7430-5(a) (as amended in 1997) (concerning administrative costs).
80. S. REP. NO. 105-33, at 304; Pub. L. No. 105-34, 111 Stat. 788 (1997); see Hong v. Comm'r, 100 T.C. 88 (1993) (holding that husband and wife were each entitled to costs since, although together the spouses had a combined net worth of over $2,000,000, each had an individual net worth of less than $2,000,000); see also Prager v. Comm'r, 68 T.C.M. (CCH) 524 (1994) (holding that where joint-filing spouses brought a joint Tax Court petition and motion for fees and only one spouse meets the financial eligibility requirements, the other spouse's right to an award of fees will not be eliminated, but the spouse will be limited to an award of only those fees allocable to that spouse).
for an award of litigation costs. The taxpayer’s failure to exhaust his administrative remedies will constitute a forfeiture of the taxpayer’s right to an award of litigation costs. A taxpayer’s refusal to grant the IRS an extension of time within which to assess any tax does not constitute a failure by the taxpayer to exhaust all administrative remedies.

Treasury regulations provide that a taxpayer has not exhausted all administrative remedies with respect to a tax matter unless the party participates in an Appeals Office conference prior to filing a petition in the Tax Court, or prior to filing an action for refund in federal district court or the U.S. Court of Federal Claims. Although this requirement seems simple to satisfy, taxpayers must be careful to sufficiently “participate” in the Appeals Office conference. Merely complying with Appeals Office formalities will not suffice. Sufficient participation at the Appeals Office conference requires that taxpayers disclose all relevant information regarding the tax matter at issue “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.”

Require taxpayers to exhaust their administrative remedies is desirable for the purposes of administrative efficiency. But the taxpayer’s inadvertent failure to comply with the procedural requirement precludes the taxpayer from recovering attorney’s fees.

If the IRS did not grant the taxpayer an Appeals Office conference before issuing the notice of deficiency, the taxpayer must have done both of the following before the issuance of the notice of deficiency: (1) requested the Appeals Office conference; and (2) filed a written protest, if a written protest is required to obtain a conference.

83. I.R.C. § 7430(b)(1) (2006). See Wilfong v. United States, 991 F.2d 359 (7th Cir. 1993) (holding that the taxpayer must meet three requirements: he must show that he exhausted all administrative remedies prior to commencing civil action, that he is a prevailing party, and that the amount of the fee request is reasonable); see also In re Lilly, 76 F.3d 568 (4th Cir. 1996) (finding that the apparent futility of exhausting administrative remedies does not justify failure to so exhaust for the purposes of section 7430).
87. Id. § 301.7430-1(b)(1)(i).
88. Id. § 301.7430-1(b)(2).
89. Id. § 301.7430-1(b)(1)(ii).
If the prevailing party filed an action for refund, the party must have requested the Appeals Office conference and filed the written protest prior to the issuance of a notice of disallowance. Taxpayers that fail to comply with the foregoing procedures will not be eligible to recover attorneys' fees for failure to exhaust their administrative remedies.

The regulations describe other circumstances in which administrative remedies will be deemed exhausted. For example, the IRS may waive the requirement that the taxpayer pursue administrative remedies by informing the taxpayer in writing that doing so is unnecessary. If the taxpayer does not receive a waiver letter from the IRS, and files a petition with the Tax Court, the taxpayer will be deemed to have exhausted his administrative remedies if, through no fault of his own, the taxpayer did not receive a 30-day letter prior to receiving the notice of deficiency, and the taxpayer agrees, if such a request is made, to participate in an Appeals Office conference while the case is in docketed status.

If the taxpayer chooses to pay the tax and file a civil action for refund, section 7430's regulations provide three different scenarios in which taxpayers will be deemed to have exhausted their administrative remedies:

(1) the taxpayer participates in a conference with the Appeals Office regarding the tax matter prior to the issuance of a notice of deficiency regarding the same tax matter;

(2) the taxpayer did not receive notice that an Appeals Office

90. Id.
91. See id. § 301.7430-1(f)(1).
92. Kaufman v. Egger, 758 F.2d 1, 3 (1st Cir. 1985) (the taxpayer will be deemed to have exhausted administrative remedies when the notice of deficiency is sent to an address where the taxpayer never lived, and the confusion was not caused by the taxpayer).
94. See id. § 301.7430-1(f)(4) (providing the circumstances under which administrative remedies will be deemed exhausted for those tax matters for which a claim for refund has been filed and such tax matters involve sections 6703 (providing the penalty rules under sections 6700, 6701, or 6702) or 6694 (actions involving the understatement of the taxpayer's income tax liability by the income tax preparer) involving generally those matters in which the taxpayer has paid a portion of a penalty pending determinations regarding the tax matter at issue).
95. Id. § 301.7430-1(f)(3)(i).
conference was available to him prior to the issuance of a notice of disallowance, and the failure to receive the notice was not the taxpayer’s fault; or

(3) the taxpayer did not receive written or oral notification that a request for an Appeals Office conference had been granted within 6 months from the date that the taxpayer filed the claim for refund, and the failure to receive notice was not the taxpayer’s fault.

(d) A Taxpayer Cannot Unreasonably Protract Litigation

A taxpayer will not be treated as a prevailing party if the taxpayer unreasonably protracted the administrative or judicial proceedings. But a taxpayer that unreasonably protracted only a portion of the administrative proceeding, but not other portions of the administrative proceeding, will be able to recover reasonable administrative costs for the portion of the administrative proceeding he did not unreasonably protract. Neither the Code nor the treasury regulations provide examples of or define “unreasonably protracting” administrative or judicial proceedings, although there are various cases involving examples of such causes.

B. The New Qualified Offer Exception

The Reform Act introduced section 7430(c)(4)(E)’s “qualified offer” exception to the prevailing party rule when the IRS position is substantially justified. The qualified offer exception permits a taxpayer to qualify as a prevailing party for the recovery of administrative and litigation costs when the amount of the taxpayer’s liability pursuant to a judgment rendered in the proceeding is less than the amount of tax

96. *Id.* § 301.7430-1(f)(3)(ii). This subsection notes that an example of the failure of receipt of the notice that an Appeals Office conference is available includes the taxpayer’s failure to disclose requested information, or the failure by the taxpayer to supply the district director or the service center having jurisdiction over the matter with a current mailing address.

97. *Id.* § 301.7430-1(f)(3)(ii).


100. See, e.g., Flagg v. United States, 53 A.F.T.R.2d 84-1321, at ¶ 9 (S.D. Iowa 1984) (holding that a taxpayer who substantially prevailed against the IRS in an audit was not entitled to an award of attorneys’ fees because the taxpayer failed to provide certain required detailed records).

101. Treas. Reg. § 301.7430-7(b)(3) (as amended in 2004), defines the “taxpayer’s
liability if the IRS had accepted the taxpayer's last qualified offer. The qualified offer exception is not available to judgments issued pursuant to a settlement. Nor does the exception apply to a proceeding in which the tax liability is not contested.

A "qualified offer" is a written offer that:

1. is made by the taxpayer to the government during the qualified offer period;
2. specifies the amount of the taxpayer's liability (determined without regard to interest);
3. is designated as a qualified offer at the time it is made; and
4. remains open until the earliest of the date the offer is rejected, the date the trial begins, or the 90th day after the date the offer is made.

The taxpayer's liability under the last qualified offer is the amount by which the taxpayer's liability (assuming the IRS accepted the taxpayer's last qualified offer)—including all of the adjustments that were contested in the administrative or judicial proceeding when the offer was made—exceeds the tax liability on the taxpayer's return. The administrative and litigation costs to which the taxpayer is entitled under this exception are limited to:

1. those incurred on or after the date of the last qualified offer;
2. those which are attributable to the adjustments when the last qualified offer was made; and

liability pursuant to the judgment" under this section as "the change in the taxpayer's liability resulting from amounts contained in the judgment as a result of the court's determinations, and amounts contained in settlements not included in the judgment, that are attributable to all adjustments that were included in the last qualified offer compared to the amount shown on the return or returns." Furthermore, the "taxpayer's liability pursuant to the judgment" does not include any amounts that are not included in the last qualified offer, without regard to any adjustments made after the last qualified offer or interest, unless such interest is at issue in the administrative or court proceeding.

103. Id.
104. Id. § 7430(c)(4)(E)(ii) (“proceedings in which the amount of tax liability is not an issue” include declaratory judgment proceedings, proceedings to enforce or quash a summons, and actions to restrain disclosure under section 6110(f)).
105. Id. § 7430(c)(4)(E).
(3) those that were also included in the court’s judgment.  

The taxpayer’s liability under the last qualified offer shall only account for interest if the taxpayer’s entitlement to interest is an issue contested in the administrative or court proceeding and is also one of the adjustments included in the last qualified offer.

A taxpayer is entitled to the benefit of the qualified offer exception only if two conditions are met: the taxpayer makes a qualified offer, or a settlement offer, consistent with the requirements of section 7430(g); and the IRS rejects the qualified offer, or fails to accept the taxpayer’s last qualified offer by the date which is the earliest of:

(a) the date the offer is rejected (the date that a notice of disallowance is issued);
(b) the date the trial begins; or
(c) the date which is the 90th day after the date the offer is made.

Treasury regulations permit the taxpayer to extend the time that the qualified offer remains open, the window within which the Service may accept the qualified offer, if the extension is made prior to the expiration of the normal period. The taxpayer must make the qualified offer to the government during the “qualified offer period” defined as

107. Id. § 301.7430-7(a). This regulation provides that the qualified offer rule is also inapplicable to those reasonable administrative and litigation costs to which the taxpayer might otherwise be entitled as a prevailing party under any other provision of section 7430(c).
108. Id. § 301.7430-7(b)(2).
109. See I.R.C. § 7430-7(c)(4)(E)(iii)(I) (2006) (stating that the qualified offer with which the amount of the judgment will be compared will be the last qualified offer by the taxpayer regarding the tax liability at issue).
110. Id. § 7430-7(g)(1)(D).
111. Treas. Reg. § 301.7430-7(c)(5) provides, however, that the extension of the period for which the qualified offer remains open will not satisfy the minimum period for a qualified offer remaining open as required by section 7430-7(c)(5) if the taxpayer would not have satisfied the requirement without such extension.
112. Delivery Requirements for Qualified Offers Made to the United States, Treas. Reg. § 301.7430-7(c)(2), provides that unless the qualified offer is mailed to an office or personnel designated in this regulation, it shall be deemed not to have been mailed. The date of the United States mail postmark shall be deemed the date of receipt by the addressee. Section 7502(f)(1) shall apply regarding designated delivery services other than the United States mail. A taxpayer has made a qualified offer to the United States when such offer is delivered to the office or personnel within the Internal Revenue
beginning on the date on which the first letter of proposed deficiency
(i.e., the 30-day letter) is sent to the taxpayer, and ending on the date
30 days prior to the day on which the case is set for trial. In refund
cases, the qualified offer period begins on the date that the notice of
disallowance is issued, unless there is no notice of claim disallowance.
In the latter case, the beginning of the qualified offer period will be the
date on which any responsive pleading is filed with the court. Although
the regulations permit the IRS to accept the qualified offer beyond
the end of the qualified offer period, the regulations prohibit any
extension of the qualified offer period. There can be no additional
time granted within which the taxpayer may make a qualified offer. But
the taxpayer may choose to grant the IRS additional time to accept the
last qualified offer made during the qualified offer period.

The taxpayer must designate his offer as a qualified offer at the
time it is made and must also include the amount that the taxpayer is

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114. Id. § 7430(g)(2)(B).
115. Treas. Reg. § 301.7430-7(c)(7) (as amended in 2004) (A case in the Tax Court
or the federal courts is considered set for trial on the date scheduled for the calendar
call).
116. Id.
2004) provides that although a taxpayer may designate an offer as a qualified offer, if
the taxpayer makes such an offer when there exists adjustments raised by the taxpayer
that are unresolved, it will not be deemed a qualified offer unless the taxpayer
contemporaneously or prior to making such offer, the taxpayer provides the United
offering as his tax liability. The government’s acceptance of the offer will fully resolve the taxpayer’s liability for the taxes and tax years involved in the proceeding.\textsuperscript{118} The amount of the qualified offer may be either a specific dollar amount representing the full amount of the taxpayer’s qualified offer, or a percentage of the adjustments determined at the time the offer is made.\textsuperscript{119} If all of the requirements regarding qualified offers are satisfied, the IRS cannot assert that its position is substantially justified.

IV. THE ART OF MEASURING THE AWARD

A. Generally

The administrative and litigation costs that a prevailing party may seek when the government’s position in the proceeding\textsuperscript{120} is not substantially justified include the imposition of:

1. attorneys’ fees limited to a statutorily-imposed maximum adjusted annually for inflation;
2. expert witness fees;
3. court costs;

States “with the substantiation and legal and factual arguments necessary to allow for informed consideration of the merits of those adjustments.” For the purposes of this section, satisfaction of the requirement of providing necessary substantiation and legal and factual arguments participation by the taxpayer (or his qualified representative) includes participating in either an Appeals office conference or an Area Counsel conference, or conferring with the Department of Justice, and at such times disclosing all relevant information, which includes, but is not limited to the legal and factual arguments supporting the taxpayer’s position in the adjustments at issue. The taxpayer will be deemed to have disclosed all relevant information if the taxpayer has supplied “sufficient information to allow informed consideration of the taxpayer’s tax matter to the extent the information and its relevance were known or should have been known to the taxpayer at the time of the conference.” \textit{Id.}

\textsuperscript{118} See I.R.C. § 7430(g)(1)(B) (stating that the offered amount is determined without regard to interest for the purposes of determining the amount of the qualified offer amount unless the interest is an issue contested in the proceeding).

\textsuperscript{119} Treas. Reg. § 301.7430-7(c)(3) (as amended in 2004).

\textsuperscript{120} I.R.C. § 7430(e) (2006) provides that actions which could have been joined or consolidated, such as cases with returns of a single taxpayer that could have been joined in a single court proceeding will be treated as a single court proceeding, whether or not actually joined, for the purpose of determining the recoverable costs, unless the court determines that to treat as such would be inappropriate.
(4) the cost of any study, analysis, engineering report, test or project necessary for the preparation of the case, based on the "prevailing market rates for the kind or quality of services furnished"; 121

(5) administrative non-litigation costs or fees similar to those charged by the IRS, under section 7430(c)(2)(A).

B. Administrative Costs

Administrative costs include only those incurred on or after the earliest of: (a) the date of the taxpayer’s receipt of the Appeals Office notice; (b) the date of the notice of deficiency; or (c) the date on which the IRS sends the first letter of proposed deficiency (30-day letter), which allows the taxpayer the opportunity for administrative review in the Appeals Office. 122

"Reasonable" administrative costs are those that are reasonable and necessary amounts the taxpayer incurs to present the taxpayer’s position regarding the merits of the tax controversy or the recovery of administrative costs. 123 Further, "reasonable administrative costs" must be reasonable in both nature and amount, and must have been incurred after the administrative proceeding date. 124

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121. Id. § 7430(c)(1)(B). Treas. Reg. 301.7430-4(c)(2)(i) (as amended in 1997) provides that prevailing market rates for representatives may be established by affidavit, and costs for expert witnesses regarding the prevailing market rates of representatives are generally not reasonable administrative costs.

122. I.R.C. § 7430(c)(2) (2006). The addition of administrative costs beginning with the letter of proposed deficiency, enacted as part of the Internal Revenue Service Restructuring and Reform Act of 1998, reflects Congress’ belief that the taxpayer should be allowed to recover reasonable costs from the first point at which the I.R.S. takes a position that is not substantially justified by issuing a proposed letter of deficiency. See H.R. REP. NO. 105-364, at 58; Pub. L. No. 105-206, 112 Stat. 685 (1998). However, administrative costs are not recoverable from the IRS unless the Service later takes a position in the notice of deficiency or an Appeals Office decision. Florida Country Clubs, Inc. v. Comm'r, 122 T.C. 73 (2004), aff'd, 404 F.3d 1291 (11th Cir. 2005). Thus, although the taxpayer must seek an Appeals Office Conference to be deemed to have exhausted the taxpayer’s administrative remedies and thus be eligible for an awards of costs, the taxpayer will not be eligible for awards of costs as to any issues to which the taxpayer settles, as the IRS will be deemed never to have taken a position although a proposed letter of deficiency was issued. Those administrative costs incurred after the proposed letter of deficiency are not recoverable as to any portion of that period before January 19, 1999.


124. Id. § 301.7430-4(c)(2). This regulation provides a thorough, but not exhaustive, list of the types of costs eligible for the award of reasonable administrative costs.
Litigation costs are distinct from administrative costs because they are not incurred in connection with an administrative proceeding.\textsuperscript{125} Litigation costs include those costs incurred both: (1) in connection with preparing and filing a petition with the Tax Court or the commencement of any other court proceeding;\textsuperscript{126} and (2) after filing a petition with the Tax Court or after the commencement of any other court proceeding.\textsuperscript{127}

In \textit{Nolfi v. United States},\textsuperscript{128} the court denied the taxpayer’s claim for litigation costs (i.e., attorneys fees) incurred in administrative proceedings before the IRS. The court disagreed with the taxpayer’s contention that such fees were properly characterized as litigation costs because they were incurred in contemplation of litigation, which the taxpayer subsequently initiated.\textsuperscript{129} Thus, the attorneys’ fees the \textit{Nolfi} taxpayer incurred did not constitute \textit{litigation costs} because they were incurred before the filing of the complaint. Nor did these costs qualify as \textit{administrative costs} because they were incurred before the Appeals Office issued its decision and before sending a notice of deficiency.\textsuperscript{130} The Reform Act, however, now permits the \textit{Nolfi} taxpayer’s costs to qualify as \textit{administrative costs} even if taxpayer incurred them before an Appeals Office decision or the issuance of a notice of deficiency. Furthermore, the Tax Court indicated that the treasury regulations applicable to administrative costs, particularly Treas. Reg. §301.7430-4

\begin{quote}
The regulation provides the following examples:

[C]osts normally included in the hourly rate of the representative [as determined] by the custom and usage of the representative’s profession, when billed separately, are not recoverable separate and apart from the representative’s hourly rate. Such costs typically include costs such as secretarial and overhead expenses. In contrast, costs that are normally billed separately may be reasonable administrative costs that may be recoverable in addition to the representative’s hourly rate. Therefore, necessary costs incurred for travel; expedited mail delivery; messenger service; expenses while on travel; long distance telephone calls; and necessary copying fees imposed by the Internal Revenue Service, any court, bank or other third party, when normally billed separately form the representative’s hourly rate, may be reasonable administrative costs.

\textit{Id.}\textsuperscript{126}.
\end{quote}

\textit{Id.} § 301.7430-4(c)(3).
\textit{Id.} § 301.7430-4(c)(3)(i).
\textit{Id.} § 301.7430-4(c)(3)(ii).
\textit{Id.} § 933 F.3d 878 (3d Cir. 1993).
\textit{Id.}
I.R.C. § 7430 ATTORNEYS’ FEES

D. Attorney Fees Are Not Just for “Attorneys”

(1) Attorney—Defined

Section 7430(c)(3) defines attorneys’ fees as fees for the services of an individual—whether or not an attorney—who is authorized to practice before the Tax Court or before the Internal Revenue Service. Thus, the statute treats fees accountants and enrolled agents charge as attorneys’ fees subject to the same statutory limitations imposed on fees charged by attorneys.132

(2) Specially Qualified Representatives—A Special Factor

Treasury Regulation §301.7430-4(b)(2) expands the definition of persons included in section 7430(c)(3) pertaining to attorneys’ fees by using the terms “representative” and “specially qualified representative.” The distinction between these two types of representatives is important because the regulations expressly provide that the limited availability of “specially qualified representatives” is a special factor justifying an increase in the maximum rate included in an attorneys’ fees award. There is, however, no such statement in the regulations regarding “representatives,” and the judicial authorities rarely considered the limited availability of “representatives” as a special factor justifying an increase in the maximum hourly rate.133 A specially qualified representative is a representative possessing a distinctive knowledge or unique and special skill that is necessary to adequately represent the taxpayer in the proceeding.134 Examples of such skill and knowledge include an identifiable practice specialty in patent or international law. The regulations, however, expressly exclude knowledge of, or experience practicing tax law as the distinctive class of knowledge or skill that is contemplated by the statute.135

134. See id. § 301.7430-4(b)(2)(ii).
135. Id. The term “specially qualified representative” does not include those who have a distinctive knowledge of the underlying subject matter of the controversy in
(3) Attorneys’ Fees Paid or Incurred

Generally, only those attorneys’ fees actually paid or incurred are eligible for consideration for an award of costs. The taxpayer must show that he paid such fees or incurred an obligation to pay them. Thus, a taxpayer may not recover those attorneys’ fees that are not billed or those which may have been incurred on the taxpayer’s behalf, but which the taxpayer has no personal obligation to pay. The pro se taxpayer will not be allowed to recover “lost opportunity costs” such as wages or other remuneration lost during the time that he conducted his case, the value of the taxpayer’s time spent preparing and participating in the administrative and litigation proceedings (i.e., in addition to any attorneys’ fees to which he may be entitled as a pro se taxpayer), or circumstances where such distinctive knowledge could be supplied through the use of an expert, or could reasonably be obtained through literature pertaining to the subject.

136. See Swanson v. Comm’r, 106 T.C. 76 (1996) (holding that the taxpayer was not entitled to litigation costs when the taxpayer had not paid for legal services and the future payment of which was contingent upon, and measured by the extent to which the taxpayer prevailed in litigation, did not qualify as an obligation to pay the fees, and thus no litigation costs allocable to attorneys’ fees were awarded); Foothill Ranch Co. v. Comm’r, 110 T.C. 94 (1998) (holding that a first-tier partner was only entitled to an award of litigation costs to the extent that the partner had been allocated such costs on the partnership’s books pursuant to the partnership agreement); see also Grigoraci v. Comm’r, 122 T.C. 272 (2004) (noting that the taxpayer, CEO/partner of an accounting firm was not allowed an award of attorneys’ fees for services rendered by the partnership’s personnel because the CEO/partner, despite his representation that he would promptly reimburse the partnership with any funds the IRS awarded to him, failed to show that he was legally obligated, or expected, to pay the invoiced amounts of fees); Kruse v. Comm’r, 77 T.C.M. (CCH) 1980 (1999) (holding that fees not be awarded because they were paid by taxpayer’s husband’s employers’ benefits plan); McCormack v. United States, 83 A.F.T.R.2d 99-520 (W.D. Wash. 1998) (the court awarded attorneys’ fees and other litigation costs to taxpayer incurred during her refund claim although her employer actually paid the fees); Thompson v. Comm’r, 72 T.C.M. (CCH) 1036 (1996) (holding that when, with respect to deficiencies that were asserted against taxpayer and her husband, same counsel was retained by taxpayer and her husband, the court did not award fees, reasoning that taxpayer never intended to incur or pay the fees when, regarding the check which taxpayer wrote to her husband to reimburse him, (1) a summary of the taxpayer’s assets showed that she lacked the funds from which to draw the amount of the check, (2) the check was written after the court requested stipulated facts concerning whether the taxpayer had paid or incurred the fees, and (3) the check was dated two days after she gave a sworn affidavit stating that she had in fact paid or incurred the fees and costs).


the value of his research time\textsuperscript{139} as reasonable litigation costs. Furthermore, an attorney representing himself or his law firm may not recover fees or costs for such representation, unless the relationship between the law firm and the attorney is so attenuated as to be inconsequential.\textsuperscript{140}

(4) Pro Bono Services

Section 7430(c)(3)(B) permits fee awards in excess of the attorneys’ fees the taxpayer actually paid or incurred if the fees are less than reasonable attorneys’ fees because the individual is representing the prevailing party for a nominal fee or no fee. This exception applies only if the award is paid to the individual or the individual’s employer who provided the pro bono services.\textsuperscript{141}

(5) Statutory Fee Cap

Attorneys’ fee awards are:

(1) based on prevailing market rates for the kind and quality of services;

(2) calculated exclusive of interest;\textsuperscript{142} and

(3) subject to a statutory cap.\textsuperscript{143}

Section 7430 fee awards for administrative or litigation costs are subject to a maximum hourly rate as authorized by the Internal Revenue

\textsuperscript{139} Dunaway v. Comm’r, 124 T.C. 80 (2005).
\textsuperscript{140} See Estate of Cervin v. Comm’r, 75 T.C.M. (CCH) 2282 (1998), aff’d, 200 F.3d 351 (5th Cir. 2000) (holding that the attorney who was a beneficiary and personal representative of the petitioning estate had a small minority interest in the law firm representing the estate and was thus entitled to recover litigation costs for the services he performed on behalf of the law firm); see also Mair, Caniel & Kovach, P.S. v. United States, 82 A.F.T.R.2d 5946 (W.D. Wash. 1998) (holding that an attorney who had a substantial equity interest in his law firm did not represent himself because the law firm engaged him in his individual capacity and paid him outside of his compensation as a firm member, which seems to be a broader holding than the Tax Court’s in Estate of Cervin).
\textsuperscript{142} Miller v. Alamo, 992 F.2d 766 (8th Cir. 1993).
\textsuperscript{143} I.R.C. § 7430(c)(1)(iii) (2006).
Code. This maximum hourly rate is adjusted annually\textsuperscript{144} to account for inflation. The maximum hourly rate is $180 for fees paid or incurred in 2009 before accounting for any special factors.\textsuperscript{145}

The Tax Court held that when a taxpayer was billed both an hourly fee and a flat fee for the balance of the services rendered, the hourly billings were not limited by the statutory maximum because the average hourly rate, as calculated with both the flat fee and the separate hours, was less than the statutory rate.\textsuperscript{146} Treasury regulations provide that costs normally included in the hourly rates of a taxpayer’s representative according to custom and usage is not separate from the hourly rate even when billed separately.\textsuperscript{147} Thus, because overhead and secretarial fees traditionally are included as part of attorneys’ hourly fees, they are not recoverable as part of attorneys’ fees in calculating reasonable administrative and litigation fees. Necessary costs incurred for travel, expedited mail delivery, messenger service, expenses while traveling, long distance telephone calls, and necessary copying fees either the IRS, any court, bank or other third party imposes, when normally billed separately form the representative’s hourly rate, may be reasonable costs.\textsuperscript{148} Several courts have held that various miscellaneous costs are separately recoverable as administrative and litigation costs.\textsuperscript{149}

\begin{itemize}
\item \textsuperscript{144} Treas. Reg. § 301.7430-4(b)(3)(i) (as amended in 1997).
\item \textsuperscript{145} Rev. Proc. 3-38, 2008-66 I.R.B. 1107.
\item \textsuperscript{146} Estate of Russell v. Comm’r, 76 T.C.M. (CCH) 978 (1998).
\item \textsuperscript{147} Treas. Reg. § 301.7430-4(c)(2) (as amended in 1997).
\item \textsuperscript{148} \textit{Id.} See Buck v. Comm’r, 65 T.C.M. (CCH) 1743 (1993) (holding that costs claimed by a taxpayer that represented himself was not entitled to separately awardable litigation costs for mileage, parking, medical bills, and his life insurance policy).
\item \textsuperscript{149} See, e.g., United States v. Sam Ellis Stores, Inc., No. 91-55969, 1992 U.S. App. LEXIS 33370 (9th Cir. 1992), aff’g 768 F. Supp. 286 (S.D. Cal. 1991) (holding that electronic research is a normal litigation expense); see, e.g., Powers v. Comm’r, 100 T.C. 457 (1993) (allowing expenses incurred for LEXIS as separate expenses, separate expenses for certified copies and telecopy expenses, and allowing minimal mileage fees as separately recoverable litigation expenses; but disallowing word processing expenses reasoning that such expenses have traditionally been treated as general secretarial expenses, which are included as overhead in attorneys’ hourly fees); Han v. Comm’r, 66 T.C.M. (CCH) 499 (1993) (allowing expenses incurred for Westlaw research, reasonable costs for law clerks, paralegal expenses, accounting services, and staff overtime expenses, and also allowing separate awards for reasonable costs for minimal parking costs for the taxpayer’s attorney, messenger services, unspecified telephone costs, and the costs for local transportation of the taxpayer’s attorneys); Nolfi v. United States, 70 A.F.T.R.2d 92-5604 (E.D. Pa. 1992) (disallowing separate expenses for computerized legal research because the court considered such costs to be part of the
\end{itemize}
Although the majority of these cases occurred before promulgation of current treasury regulations under section 7430, the jurisprudence considered collectively reflects the distinction characterized in the regulations as either: (a) attorney overhead expenses, which are deemed included in attorney's hourly rates; (b) other expenses typically included in an attorneys' fees; or (c) expenses that an attorney usually charges separately.150

(6) Special Factor Adjustments

Generally, attorneys' fees are not awarded under section 7430 in an amount greater than the statutory maximum unless a higher rate is justified by a special factor,151 including:

attorney's hourly fee; disallowing messenger services as a fee separate from attorneys' fees; disallowing travel expenses and the cost of staff overtime reasoning that they are more properly characterized as part of the attorney's overhead expenses; disallowing separate fees for long distance telephone calls and telexes; McConaughy v. United States, 833 F. Supp. 534 (D. Md. 1993), aff'd, 74 A.F.T.R.2d 5931 (4th Cir. 1994) (paralegal fees, parking expenses incurred by taxpayer's attorneys, phone call and facsimile expenses are included in attorney's overhead and are not separately recoverable; allowing messenger fees as separately recoverable costs litigation costs); Huffman v. Comm'r, 67 T.C.M. (CCH) 2237 (1994) (allowing separately recoverable charges for paralegal fees, copying charges, mailing expenses, long-distance telephone calls); Wade v. United States, 865 F. Supp. 216 (D.N.J. 1994) (copying charges are separately awardable litigation costs, mailing costs and travel costs are also separately recoverable litigation costs because they are inevitable in any litigation). See, e.g., Buck v. Comm'r, 65 T.C.M. (CCH) 1743 (1993) (allowing separate awards of mailing expenses, couriers charges, and copying charges); Mullins v. United States, 95 A.F.T.R.2d 2005-1612 (E.D. Tenn. 2005) (allowing separately recoverable costs for mailing costs, copying costs and accountant time, but law clerk time was not a separately allowable litigation expense); McWilliams v. Comm'r, 69 T.C.M. (CCH) 2107 (1995) (New Mexico state gross receipts tax on attorney fees is part of attorney's overhead cost and is not separately recoverable); Buchanan v. United States, 765 F. Supp. 642 (D. Or. 1991) (paralegal, law clerk, and legal assistant fees are separately recoverable fees); O'Bryon v. Comm'r, 80 T.C.M. (CCH) 859 (2000) (reasonable costs for paralegal are recoverable); Concerned Care, Inc. v. United States, 88 A.F.T.R.2d 97-7569 (W.D. Pa. 1997) (paralegal fees were recoverable separate from attorneys' fees); K.S. Fin. Group, Inc. v. Schulman, 88 A.F.T.R.2d 2001-5282 (N.D. Ga. 2001) (holding that computerized legal expenses are considered part a of attorney's hourly fees).

151. The current treatment of "special factors" applies to all costs incurred more than 180 days after the July 22, 1998, effective date of the Internal Revenue Service Restructuring and Reform Act of 1998. Prior to the Reform Act, the Internal Revenue
(1) the limited availability of qualified attorneys for such proceedings;
(2) the difficulty of the issues presented in the case; and
(3) the local availability of tax expertise.¹⁵²

For the purposes of demonstrating the limited availability of a specially qualified representative, the taxpayer must show that a specially qualified representative is not available at the statutory rate.¹⁵³ Treasury regulations explicitly exclude the following from the "special factors" justifying an award of attorneys’ fees greater than the statutory maximum:¹⁵⁵

- undesirability of the case;
- work and the ability of counsel;
- results obtained;
- customary fees and awards in other cases; and
- the limited availability of specially qualified representatives.

Code did not define special factors further than stating that the limited availability of specialized attorneys would qualify as a special factor. Under the pre-Reform Act statutory standard the Tax Court stated: "[I]n order for the "limited availability of qualified attorneys" to constitute a special factor warranting departure from the [statutory] cap, there must be a limited availability of attorneys who possess distinctive knowledge or a specialized skill needful to the particular litigation in question." Cozean v. Comm’r, 109 T.C. 227, 232 (1997).

¹⁵³ Treas. Reg. § 301.7430-4(b)(3)(iii)(C) (as amended in 1997). Initially this showing may be made by submitting an affidavit demonstrating that a specially qualified representative that practices within a reasonable distance from the taxpayer’s principal residence or principal office would normally charge a client similar to the taxpayer at a rate in excess of this amount.
¹⁵⁴ There is an apparent conflict between section 7430(c)(1)(B)(iii) and Treas. Reg. § 301.7430-4(b)(3)(iii)(B) on the issue of whether "difficulty of the issues presented" is a special factor warranting an enhancement of attorneys’ fees. The conflict arises because the regulation was promulgated before the Reform Act in 1998 expanded the definition of special factors to add "the difficulty of the issues presented in the case." See Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3101(a)(2), 112 Stat. 685 (1998). Thus, contrary to the cited regulation and Cozean v. Comm’r, 109 T.C. 227 (1997), the difficulty of the issues presented may be a special factor that justifies a higher attorney’s fee award.
The Tax Court has not usually enhanced attorneys’ fees above the statutory maximum rate unless the taxpayer demonstrated that the attorney who obtained exceptional results had distinctive knowledge or special skill apart from being a tax practitioner. In such cases, the Tax Court required the taxpayer to show that the exceptional results were attributable to the special skill or knowledge that the attorney possessed. Furthermore, in Dang v. Commissioner the Tax Court held that “applying post-1998 tax law, tax expertise is not a special factor.”

Although the Tax Court does not appear to have ever enhanced an award of attorneys’ fees due to “special factors,” Congress’ inclusion in section 7430 of special factors for courts to consider could be characterized as an express rejection of the Tax Court’s refusal to consider the skill of the tax practitioner and the prevailing geographical market rates for the tax practitioner’s services. Notably, numerous courts have concluded that tax law expertise alone, even when the attorney holds an LL.M. in Taxation, is not a special factor justifying an enhanced award of attorneys’ fees. Several courts reasoned that because section 7430 pertains exclusively to tax cases, treating tax expertise as a special factor would result in the exception swallowing the rule, because most attorneys seeking attorneys’ fees in tax litigation possess expertise in tax law.

Decisions of federal courts indicate an approach to enhancing attorneys’ fees awards that is more liberal than the Tax Court. Some district courts and the Ninth Circuit have held that tax expertise was

156. The Tax Court has held that for the limited availability of qualified attorneys to constitute a special factor, there must be a limited availability of attorneys possessing the distinctive knowledge or specialized skill that is required by the particular litigation, rather than merely an extraordinary level of general lawyerly knowledge. Cozean v. Comm’r, 109 T.C. 227, 232 (1997).
158. In Kenagy v. United States, 72 A.F.T.R.2d 93-5689 (W.D. Mo. 1993), the district court held that the taxpayer’s attorney who had an LL.M. in Taxation, and who was a professor of tax law did not possess the skill or distinctive knowledge contemplated by the statute, thus an enhanced award of attorneys’ fees was not justified. However, in Curell v. United States, 88 A.F.T.R.2d 2001-6682 (S.D. Ohio 2001), the district court held that an attorney’s LL.M. in Taxation and his specialized expertise justified a higher rate. See Urell v. United States, 88 A.F.T.R.2d 2001-6682 (S.D. Ohio 2001) (exemplifying a scenario where the IRS did not acquiesce to the district court position in Curell that an LL.M. in Taxation justifies a higher-than-statutory rate.)
a special factor justifying an enhancement in the attorneys' fees award. There is disparity among appellate courts regarding those factors warranting an enhancement of attorneys' fees. One district court opinion noted that the Seventh, Ninth, and Eleventh Circuits have interpreted the Supreme Court's holding in *Pierce v. Underwood* as permitting enhancement in situations in which an attorney has specialized expertise in a particular area of law. The District of Columbia, Fourth, and Fifth Circuits have interpreted *Pierce* as permitting fee enhancement only when attorneys have a specialty that requires expertise or education other than in the field of law.

Section 7430(c)(1)(B) authorizes a taxpayer to recover reasonable expenses incurred for expert witnesses, as determined by prevailing market rates, for a court proceeding. Nonetheless, a taxpayer may not receive an award for reasonable costs expended for experts that exceeds the highest rate of compensation for an expert witness the government retained.

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160. *See* United States v. Sam Ellis Stores, Inc., 981 F.2d 1260 (9th Cir. 1992), aff'g 768 F. Supp. 286 (S.D. Cal. 1991) (affirming an enhancement of the statutory rate under section 7430 when the attorney was a state bar certified tax specialist and a CPA and the issues involved complex currency devaluation issues, however, the court held that although the government failed to prevail their position was substantially justified, and thus, the tax did not receive any award of attorneys' fees).


162. *Pierce v. Underwood*, 487 U.S. 552 (1988) (holding that the exception to the statutory fee limit for attorneys' fees in this case of special factors "refers to attorneys having some distinctive or specialized skill needful for the litigation in question—as opposed to an extraordinary level of the generally lawyerly knowledge and ability useful in all litigation").


165. *Id.*
(7) Special Considerations for Accountants and Enrolled Agents

Awards of attorneys' fees are available to certified public accountants and enrolled agents authorized to practice before the Internal Revenue Service and the Tax Court. Such fees are also subject to the same limitations on maximum hourly fees at which attorneys' fees may be awarded. The Tax Court, however, has held that fees paid to individuals who are not authorized to practice before the Tax Court are reimbursable as reasonable litigation costs only if the services provided: (1) related to the legal aspects of the taxpayer's litigation; and (2) were carried out under the direction or employ of an individual—whether or not an attorney—who is authorized to practice before the Tax Court.

In McWilliams v. Commissioner, the Tax Court further restricted the availability of attorneys' fees awards for the services of non-attorneys. In McWilliams the court held that fees the taxpayer paid to an accountant were not reasonable because: (1) the taxpayer also had two attorneys (one of whom was a CPA) working on his case, and the billing summary for accounting services was vague and non-descriptive; and (2) there were entries in the accountant's billing summaries referring to discussions with attorneys that had no corresponding entries in the attorney's billing summaries.

In Cozean v. Commissioner, however, the Tax Court awarded attorneys' fees to the taxpayer for fees paid to accountants certified to practice before both the IRS and the Tax Court even though counsel also represented the taxpayer.

V. APPLICATION PROCEDURE AND JUDICIAL PROCEEDINGS

A. Generally

The recovery of attorneys' fees, litigation and administrative costs is available in connection with the determination, collection, or refund of any tax imposed under the Internal Revenue Code. Although section 7430 provides subject matter jurisdiction over requests for adminis-

169. Id.
trative and litigation costs with the Tax Court, Court of Federal Claims, and the federal district courts, in those cases in which the substantive tax issues have been resolved at the administrative level, subject matter jurisdiction over the taxpayer’s requests for an award of costs rests exclusively with the Tax Court.

**B. Application and Judicial Proceeding for Administrative Costs**

A prevailing party seeking an award of administrative costs under section 7430(c)(2) must file an application with the IRS before the 91st day after the date on which the final decision of the IRS as to the determination of the tax, interest, or penalty is mailed to him.\(^1\) The Tax Court has jurisdiction to decide taxpayer appeals from IRS decisions granting or denying (in whole or in party) awards for reasonable administrative costs.\(^2\) An action for administrative costs is the commencement of a new case. Rather than being subject to the procedural rules applicable to motions for litigation costs and administrative costs arising from a deficiency proceeding currently before the Tax Court, a separate action for only administrative costs is instead procedurally analogous to a small tax case.\(^3\) Not all rules of small case procedure are applicable, however. For example, answers must be filed in all actions for awards of reasonable administrative costs.\(^4\) The Tax Court’s disposition of a prevailing party’s petition seeking an award of administrative costs pursuant to section 7430(f)(2) is reviewable in the same manner as a decision of the Tax Court.\(^5\)

**C. Judicial Proceedings for Litigation and Administrative Costs**

(1) **Tax Court**

A prevailing party may file a motion for litigation and administrative costs in the Tax Court:

(1) within 30 days of the service of the opinion determining the issues in the case;

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\(^2\) Id. § 7430(f)(2); TAX CT. R. 270.

\(^3\) TAX CT. R. 230-33, 271-74.

\(^4\) Id. R. 232.

(2) within 30 days from the service of the transcript that contains findings in fact or an opinion stated orally (or a written summary of the oral opinion); or

(3) after the parties have settled all issues in the case other than litigation and administrative costs.\textsuperscript{176}

The IRS will file a written response to every motion for an award of reasonable litigation or administrative costs.\textsuperscript{177} The response shall be filed within 60 days after service of the motion.\textsuperscript{178}

The disposition of a motion for reasonable administrative and litigation costs must be included in the decision of the case.\textsuperscript{179} This rule is intended to simplify the appeal procedures by incorporating into a single document the disposition of both the substantive issues of the case and the motion for costs. Thus, the disposition of a motion for costs may be appealed in the same manner as the judgment in the case. Section 7430 also provides taxpayers with an automatic right to appeal the Tax Court's unexplained summary denial of a motion for litigation costs.\textsuperscript{180}

(2) U. S. District Court

Federal district courts are split along two lines regarding the applicable period within which to seek litigation costs. One line holds that the rule of the district courts (i.e., Rule 54(d) of the Federal Rules of Civil Procedure) prescribes the period within which taxpayers must seek litigation costs.\textsuperscript{181} The other line applies the 30-day rule of 28 U.S.C. §2412(d)(1)(B) because it is the statute incorporated into section 7430(c)(4)(A)(ii) regarding applications for litigation costs.\textsuperscript{182} One

\textsuperscript{176} See Tax Ct. R. 231(a)(2). However, in Minahan v. Comm'r, 88 T.C. 516 (1987), the Tax Court permitted a taxpayer to submit an application for fees after the entry of a stipulated decision. But, in Manchester Group & Subsidiaries v. Comm'r, 68 T.C.M. (CCH) 1383 (1994), the court denied a motion for costs when the taxpayer filed the motion to vacate and revise the decision so that the taxpayer could raise the issue of litigation costs when the motion was filed four days after the 90-day period for appealing the decision expired.
\textsuperscript{177} I.R.S. Manual § 35.10.1.1.1(6) (Aug. 11, 2004); Tax Ct. R. 232.
\textsuperscript{178} Tax Ct. R. 232(b).
\textsuperscript{179} Id. R. 232(f).
\textsuperscript{182} Overton v. United States, 83 A.F.T.R.2d 99-493 (10th Cir. 1999); O'Banion v.
district court explained this reasoning by stating that the federal district court rule regarding the recovery of attorneys’ fees does not apply in section 7430 cases because (a) Rule 54(d) of the Federal Rules of Civil Procedure expressly states that the rule applies “unless otherwise provided by statute”; and (b) section 7430 expressly incorporates the 30-day period prescribed by 28 U.S.C. §2412(d)(1)(B).

D. “Fees for Fees” Litigation

“Fees for fees” litigation seeks to recover the fees incurred in the preparation and submission of a request for the recovery of reasonable litigation and administrative costs when a court has determined that the IRS position was not substantially justified, and the taxpayer’s recovery of fees is justified. Entitlement to “fees for fees” may not arise until after the controversy as to the substantive tax issues has concluded because the taxpayer may not make a motion to the court for the recovery of fees until the court has rendered a decision. Significantly, the taxpayer may remain eligible for the recovery of “fees for fees” even when the taxpayer has failed to timely file for such fees.
VI. CONCLUSIONS AND RECOMMENDATIONS

The Reform Act provided several significant pro-taxpayer amendments in light of the previous versions of section 7430. The most significant legislative reforms included, increasing the hourly amount of attorney fees, awarding reasonable administrative fees retroactive to the initial 30-day letter, permitting the recovery of fees by pro bono attorneys, and allowing taxpayers to submit qualified offers.

Notwithstanding the foregoing, section 7430 still fails to provide taxpayers with real leverage in their negotiations with the IRS. Effective functioning of the statute would require that the IRS weigh the consequences of overreaching, and upon analyzing its position, the IRS would determine, when appropriate, that the potential risk of asserting an unjustified position outweighs the potential benefit of challenging a taxpayer’s position. However, because section 7430’s limitations and procedural burdens result only in anomalous awards of fees and costs, 7430 certainly falls short of amounting to an imposing factor demanding the IRS’s consideration in its challenges to taxpayer positions. The perceived likelihood and potential size of an award of attorneys’ fees and costs to taxpayers must be great enough to: (1) prevent the IRS from policy-making at the taxpayers’ expense and (2) achieve Congress’ intent that 7430 serve as a deterrent to abusive IRS practices and IRS overreaching. Section 7430 is currently failing on both fronts.

Congress should amend section 7430 to provide greater protections for taxpayers from IRS overreaching. Specific protective measures should include:

- fixing the time and manner in which the IRS would adopt its “position” to preclude the IRS from changing its position as the administrative proceeding evolves;
- increasing the specific net worth limitations for qualifying taxpayers;
- providing guidance in determining if the IRS position is substantially justified;
- simplifying the qualified offer rules;
- and, most importantly, recognizing that special tax expertise (e.g., advanced taxation degrees, substantial experience in handling tax controversies) is a sufficient factor to support a rate higher than the minimum statutory rate for attorneys’ fees.

Id.
Implementing these measures will establish Internal Revenue Code § 7430 as the statute Congress intended: a shield for taxpayers who have taken legitimate tax positions to protect against overreaching by the behemoth Internal Revenue Service.