

REPORT #832

TAX SECTION

New York State Bar Association

Burden of Proof in Tax Cases

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March 23, 1995

**MEMORANDUM TO THE MEMBERS OF THE HOUSE
WAYS & MEANS SUBCOMMITTEE ON OVERSIGHT***Re: H.R. 390 -- Burden of Proof
in Tax Cases

We understand the House Ways & Means Subcommittee on Oversight is conducting hearings on Friday, March 24, 1995, on H.R. 390, a bill that would amend the Internal Revenue Code (i) to shift the burden of proof on all matters in all tax cases to the government; (ii) to require a specific identification of regulations requiring recordkeeping; and (iii) to increase the limit on civil damages for unauthorized collection activities from \$100,000 to \$1,000,000, and to exempt such awards from income tax. We take no position on the second and third sections of the bill.

* This memorandum was prepared by Carolyn Joy Lee, Chair of the Tax Section, with input and helpful commentary from: Andrew N. Berg, Wm. L. Burke, John A. Corry, Peter L. Faber, Stuart J. Goldring, Richard O. Loengard, Stephen L. Millman, James M. Peaslee, Robert Plautz, Richard L. Reinhold, Donald Schapiro, Joel Scharfstein, Michael L. Schler, Michelle P. Scott, Esta Stecher, Jonathan A. Small, David E. Watts, and Philip R. West.

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It is however our strong opinion that the proposal to shift the burden of proof on all issues in tax cases to the government is an exceptionally bad idea. This proposal would, in our view, seriously undermine the voluntary compliance that is essential to our federal tax system, and would likely lead to audits and litigation of unprecedented intrusiveness and intensity.

Consider a few simple examples of the problems this bill presents. Under present law, a taxpayer who has claimed a deduction must substantiate the deduction by producing evidence thereof. Under the proposed legislation, however, it would appear that, instead of the taxpayer being required to substantiate his deductions, the IRS instead would be required to prove that the taxpayer did not make the expenditures for which deductions are claimed. In a similar vein, it would be difficult for the government to prove that an expenditure was made for personal rather than business purposes, or to prove the relationship (or lack thereof) between a taxpayer and its affiliate, or to prove the value of property, when the taxpayer controls the evidence. And how will the government be able effectively to pursue a transfer pricing case involving persons and records located in foreign jurisdictions? What happens in these cases if the taxpayer no longer has the relevant records and claims to be unable at the time of the audit to provide evidence? What evidence is the Internal Revenue Service required to present to meet its burden of proof? These questions -- a tiny sample of the issues this bill presents -- illustrate the fundamental problems that would arise if the burden of proof is imposed on the party who does not control or have full and timely access to the evidence.

In our view the tax system simply cannot function if the burden of proof on all matters in all tax cases is shifted to the government. The knowledge that one must substantiate and prove the items on one's tax returns is a tremendously important element of

our system of self-assessed taxes. The bill would remove that check on all filers, and further compound the government's burden on the very small percentage of returns that are audited.

We are also concerned that if the burden of proof is imposed upon the Internal Revenue Service federal audits will become much more intensive and intrusive, as the Service will need to probe much more deeply into the taxpayer's affairs, and frequently into the affairs of people collaterally involved in the matter, to meet its burden of proof. Similarly, the shift in burden of proof also will likely affect tax litigation, as taxpayers will want to avoid making stipulations, preferring instead to let the government prove its case. This could materially increase the burden of tax litigation on the courts, especially the Tax Court. The administration of the tax law is thus likely to become far more costly if the burden of proof on all matters is shifted to the government.

We do not doubt that H.R. 390 is well-intentioned. We recognize that abuses do occur, and that there are cases in which taxpayers have incurred great hardship and expense defending against what proved to be baseless assertions of tax liability. We also acknowledge that there may be aspects of the tax law in which it could be appropriate to shift the burden of proof to the government. The recent report of the Joint Committee on Taxation on H.R. 390 (JCX-15-95) included a list of fourteen specific civil provisions of the Code in which the Commissioner bears the burden of proof; it may well be appropriate and timely to give considered analysis to whether there are additional types of issues that should be added to this list.

We believe however, that this proposal to effect a global shift in the burden of proof on all matters in all tax cases is misguided, and we trust that, upon further consideration, this proposal will be

rejected. This bill raises more than just some arcane issue of tax procedure; enactment of this bill would eviscerate voluntary tax compliance, and vastly complicate audits, inflicting enormous damage on the integrity of the federal tax system.

We urge that this proposal not be enacted. If you or your staffs would like to discuss this further please do not hesitate to contact the Chair of the Tax Section.