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The Parameters of Qualified Amended Returns Examined by Tax Court in Case of First Impression, Journal of Taxation, Feb 2012

PROCEDURE

The Parameters of Qualified Amended Returns Examined by Tax Court in Case of First Impression

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A powerful remedy that may enable a taxpayer to avoid substantial penalties, the qualified amended return rules are complicated and perhaps not as well known as they might be. One particular difficulty is that a taxpayer must file an amended return before IRS contacts a third-party shelter promoter, a development of which the taxpayer may be completely unaware.

Life grants few chances at true redemption. The Code, likewise, is not known for facilitating taxpayer salvation. To be sure, under certain circumstances taxpayers have an opportunity to file late tax-related elections to rectify an oversight, and other forms of clemency exist. Nevertheless, the general rule is that taxpayers are stuck with a position once they take it on a tax return filed the IRS.

One obscure exception to this rule is the qualified amended return (QAR), which can be a powerful self-help remedy for taxpayers who experience the "oh-shoot" moment. This event often occurs when taxpayers realize that, oh shoot, they forgot to include certain income items on their tax return or, oh shoot, they cannot sleep because the stance they took on their tax return was too aggressive. Filing a QAR in these situations may allow a taxpayer to sidestep penalties stemming from the inaccurate tax return.

Of course, the QAR rules, like most things tax, are complex. A recent case of first impression in the Tax Court, *Bergmann*, 137 TC No 10, Tax Ct Rep Dec (RIA) 137.10, 2011 WL 4809047, provides an opportunity to analyze the purpose, application, intricacies, and evolution of the QAR rules.

OVERVIEW—CODE AND REGULATIONS

In order to understand the issues raised in *Bergmann*, one first must be familiar with two key tax provisions: Sections 6662 and 6700.

Where a tax underpayment is attributable to one of several things, including a taxpayer's negligence or disregard of applicable tax rules and Regulations, the Code generally provides that the IRS can assert an "accuracy-related" penalty equal to 20% of the tax underpayment.¹ An important issue, therefore, is determining what an "underpayment" is in this context.

In grossly simplified terms, an underpayment is the difference between the tax liability that an individual reported on his federal income

tax return (i.e., Form 1040) and the tax liability that should have been reported, if the taxpayer had completed his Form 1040 correctly. ² For instance, where the taxpayer's true tax liability was \$100,000 but he only reported \$80,000 on his Form 1040, the Service ordinarily could assert a penalty of \$4,000, i.e., 20% of the \$20,000 underpayment. ³

A little-known mechanism exists whereby a taxpayer can reduce or eliminate the tax underpayment *after* filing the original Form 1040 with the IRS. This is the QAR. In essence, if a taxpayer files his Form 1040 and later realizes that it contained a tax underpayment, he may have a limited opportunity to submit a QAR to rectify the situation. According to the Regulations, for purposes of determining the applicability or size of accuracy-related penalties under Section 6662, the tax liability shown on the original Form 1040 includes the amount of additional tax reflected on the QAR. ⁴ Thus, in the example above, if the taxpayer filed a Form 1040 showing a tax liability of \$80,000 but subsequently submitted a QAR to the IRS indicating a revised liability of \$100,000, no underpayment would exist and the Service would have no grounds for asserting an accuracy-related penalty under Section 6662(a).

One of the biggest challenges for taxpayers is convincing the IRS or the courts that the Form 1040X they filed constitutes a QAR, as this term is narrowly defined. Often, the focus is on the taxpayer, because a Form 1040X will not be considered a QAR unless it is filed before the IRS contacts the taxpayer concerning an examination of the Form 1040. ⁵ Several courts have held that Forms 1040X did not constitute QARs because they were filed too late.

For example, in *Perrah*, TC Memo 2002-283, RIA TC Memo ¶2002-283, the Tax Court rejected QAR status because the Forms 1040X were filed with the IRS service center after the Service had commenced an examination. Likewise, in *Wilkerson*, TC Summ Op 2004-99, 2004 WL 1663399, the Tax Court refused to classify Forms 1040X as QARs when the taxpayer filed them with the Appeals Office after the IRS had issued a notice of deficiency and after the taxpayer had filed a petition with the Tax Court.

Bergmann involves a more obscure aspect of QAR limitations, a focus not on the taxpayer but on other persons with whom the taxpayer may have somehow dealt. The Regulations have been modified and expanded several times since their introduction approximately 20 years ago, but the version of Reg. 1.6664-2(c)(3)(ii) applicable to *Bergmann* stated that a Form 1040X is a QAR if it is filed before the following:

"The time any person described in section 6700(a) ... is first contacted by the Internal Revenue Service concerning an examination of an activity described in section 6700(a) with respect to which the taxpayer claimed any tax benefit on the return directly or indirectly through an entity, plan or arrangement described in section 6700(a)(1)(A)...." ⁶

Given the cross-references to Section 6700 in the preceding definition of QAR, it is necessary to turn to this provision, whose title displays no subtlety: "Promoting Abusive Tax Shelters, etc." This statute allows the Service to assert "promoter penalties" against two main categories of people, both of whom are described in Section 6700(a) :

(1) Under Section 6700(a)(1), the IRS can penalize any person who either personally organizes or assists in the organization of a partnership or other entity, an investment plan or arrangement, or any other plan or arrangement, or participates directly or indirectly in the sale of any ownership interest in any such an entity, plan, or arrangement. In essence, the Service uses Section 6700(a)(1) to castigate persons who organize or sell "tax shelters" to taxpayers.

(2) Under Section 6700(a)(2), the IRS can pursue any person who makes or furnishes or causes another person to make or furnish (in connection with the organization or sale of the entity, plan, or arrangement) a statement regarding the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by the taxpayer because of holding an ownership interest in the entity or participating in the plan or arrangement, and the person actually knows or has reason to know that the statement is materially false or fraudulent. ⁷ In short, the IRS relies on Section 6700(a)(2) to punish persons who intentionally make or cause others to make inaccurate or deceitful statements (in tax/legal opinion letters and otherwise) to the taxpayer regarding a "tax shelter."

ANALYSIS OF BERGMANN

Accurately conveying the facts in *Bergmann* is challenging because the Tax Court opinion focuses on a few specific issues and the briefing by the parties paints two very different pictures. The critical facts, derived from a variety of somewhat conflicting sources, are set forth below. ⁸

During the late 1990s and early 2000s, KPMG developed various tax-advantaged transactions that the IRS considered to be "tax

shelters." It did so through a group called "Stratecon," which focused on designing, marketing, and implementing such transactions. David Greenberg, a tax partner in the Los Angeles office of KPMG from 1999 to 2003, was a member of Stratecon. According to the IRS, Greenberg was involved in promoting various transactions to business and individual clients of KPMG, including the so-called "short option strategy" (SOS). The Service provided evidence that Greenberg was assisting certain KPMG partners who participated in SOS transactions, too.

Greenberg allegedly orchestrated an arrangement whereby Lee, Goddard & Duffy (LGD), a law firm headed by a longstanding friend and former coworker, would act as the taxpayer's "legal advisor" for the SOS transaction. The IRS claimed that LGD, in its role of legal advisor, often retained KPMG to issue tax opinions associated with various SOS transactions, and Greenberg authored those opinions. The supposed purpose of this relationship was to ensure that the tax opinions were covered by the attorney-client privilege.

The IRS indicated that KPMG ceased issuing tax opinions at some point, after which Greenberg made arrangements with Steven Corbin, an accountant in charge of an accounting firm with approximately 140 employees, to provide tax opinions to LGD in connection with the SOS transactions. The tax opinions issued by Corbin, the Service suggested, were virtually identical to those previously prepared by KPMG and Greenberg.

Jeffrey Bergmann also was a partner in KPMG's Los Angeles office during virtually the same period as Greenberg. In 2000, Bergmann retained LGD to assist him engage in an SOS transaction (the "2000 transaction") and hired Corbin to prepare the related tax opinion. The next year, Bergmann entered into a similar transaction and relationship with legal/tax professionals (the "2001 transaction").

According to the IRS, in both instances Greenberg introduced Bergmann to LGD and Corbin, but Greenberg did *not* (1) open a file for the Bergmann matter at KPMG, (2) send any bills to Bergmann, (3) receive any fees from Bergmann, (4) prepare a tax opinion or any other written statement about the SOS transaction for Bergmann, (5) hire LGD or Corbin, (6) review a draft version of the tax opinion issued by Corbin, or (7) receive a copy of the tax opinion in final form.

On his original 2001 Form 1040, Bergmann claimed a loss of \$346,609 related to the 2000 transaction, as well as a loss of \$295,500 attributable to the 2001 transaction.⁹ He filed the original 2001 Form 1040 on or about 8/19/02.

Meanwhile, back in September 2001, the IRS started an investigation to determine whether KPMG had failed to register certain tax shelters, as required by Sections 6111 and 6112. Shortly into the investigation, on 10/19/01, the Service sent a letter to KPMG notifying it, among other things, that the IRS was considering pursuing tax-shelter-promoter penalties against KPMG under Section 6700. Then, on 2/5/02, the IRS sent a letter to KPMG's counsel stating that the investigation concerned "all tax shelter activities."

Things got more serious on 3/19/02, when the Service issued two summonses to KPMG requesting information and documentation on its tax-shelter activities from 1/1/98 to the present. Each summons was titled "In the matter of the liability of KPMG LLP for IRC section 6700, 6701, 6707, 6708 penalties." One summons requested documents and information relating to transactions that were the same as or substantially similar to transactions described in Notice 2000-44, 2000-2 CB 255, i.e., transactions generating losses for taxpayers resulting from artificially inflating the basis in partnership interests (the "Notice 2000-44 summons"). The other summons requested documents and information about certain transactions that generated tax benefits greater than twice the amount of cash or other property contributed by the taxpayer (the "generic summons"). Neither summons specifically mentioned Bergmann, the 2000 transaction, or the 2001 transaction.

In response to the two summonses, KPMG provided to the IRS on 4/18/02 a list of clients that KPMG believed might have engaged in SOS transactions. This list did not identify Bergmann or any other partners at KPMG.

On 3/15/04, Bergmann filed with the IRS an amended federal income tax return (i.e., 2001 Form 1040X) removing the losses of approximately \$642,000 related to the 2000 transaction and 2001 transaction. This resulted in an additional tax liability of some \$206,000, which Bergmann fully paid. The IRS processed the 2001 Form 1040X and retained the payment.

Bergmann claimed that he did not see, obtain a copy of, or even know about the existence of the summonses to KPMG before filing his 2001 Form 1040X on 3/15/04. His motive for filing the 2001 Form 1040X was something else: concern that the California taxing agency would share information with the IRS. According to Bergmann, he participated in California's voluntary compliance initiative to rectify his state income tax issues and he believed that eventually the information provided in connection with such initiative would be routed to the IRS, thereby jeopardizing his ability to file a QAR with the IRS on a penalty-free basis.

On 6/27/04, approximately three months after Bergmann filed his 2001 Form 1040X, KPMG gave the IRS a revised list of investors in

response to the summonses, as well as hundreds of boxes of documents. The list included the names of both KPMG clients and partners who participated in the relevant transactions. The list and the boxes contained information about Bergmann's 2000 transaction, yet none on the 2001 transaction.

On 4/12/05, the Service sent Bergmann a letter informing him that his 2001 Form 1040 (and, by extension, his 2001 Form 1040X) had been selected for audit. Then, on 8/10/05, the IRS issued a notice of deficiency to Bergmann that asserted, among other things, an accuracy-related penalty on the supposed tax "underpayment" for 2001. In other words, the Service took the position in its notice of deficiency that Bergmann's 2001 Form 1040X did not constitute a QAR.

Arguments Raised by the Parties

Bergmann, like most hotly contested tax disputes, involved a significant amount of pre-trial and post-trial briefing by the parties. These documents contained numerous legal points, counterpoints, and everything in between. The trick, of course, is to review all the materials, set aside the rhetoric, ignore the inevitable squabbling, and capture the essence of the parties' positions. To achieve this goal, we first need to recap the relevant tax authorities, inserting the names of the relevant parties for the sake of clarity.

The QAR Regulations. Under Reg. 1.6664-2(c)(3)(ii), the 2001 Form 1040X filed by Bergmann on 3/15/04 would be considered a QAR if it was filed before "[t]he time any person described in section 6700(a) [possibly KPMG] is first contacted by the Internal Revenue Service concerning an examination of an activity described in section 6700(a) with respect to which [Bergmann] claimed any tax benefit on [his original 2001 Form 1040] directly or indirectly through an entity, plan or arrangement described in section 6700(a)(1) (A)...."¹⁰

The tax-shelter-promoter penalty. As noted above, Section 6700 identifies two categories of persons who could be, as the QAR Regulations say, "described in section 6700(a)." Such persons include those under Section 6700(a)(1) who organize or sell "tax shelters" to taxpayers, as well as those under Section 6700(a)(2) who purposefully make or cause others to make false or outright fraudulent statements (in tax/legal opinion letters and otherwise) to the taxpayers regarding the supposed benefits of the "tax shelter." The tax provisions, set forth below, put a more technical spin on it.

Section 6700(a)(1): "Any person [possibly KPMG] who ... organizes (or assists in the organization of) ... a partnership or other entity, ... any investment plan or arrangement, or ... any other plan or arrangement, or ... participates (directly or indirectly) in the sale of any interest in [such] an entity or plan or arrangement...."

Section 6700(a)(2): "Any person [possibly KPMG] who ... makes or furnishes or causes another person [possibly Corbin] to make or furnish (in connection with such organization or sale) ... a statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person [possibly KPMG] knows or has reason to know is false or fraudulent as to any material matter...."

With the key authorities thus clarified, we turn to some of the arguments advanced by the parties during the Tax Court litigation.¹¹

Main arguments presented by Bergmann. The taxpayer had two main contentions why the 2001 Form 1040X constituted a QAR.

KPMG was not a "person described in Section 6700(a)." As noted above, Reg. 1.6664-2(c)(3)(ii) dictates that the 2001 Form 1040X filed by Bergmann on 3/15/04 would be considered a QAR only if it was submitted to the IRS before "any person described in section 6700(a)" was first contacted by the Service about Bergmann's 2000 transaction or 2001 transaction. Bergmann argued that KPMG did not fall into this class for three principal reasons.

First, he argued that KPMG was not a person described in Section 6700(a)(1) because it did not organize or sell the SOS transactions to Bergmann. Bergmann conceded that Greenberg provided some assistance in the matter, but contended that he was acting in his personal capacity, as a friend, not as a partner of KPMG.

In support of this argument, Bergmann emphasized that Greenberg did not open a file for Bergmann at KPMG, bill any time on the project, or send any invoices. Bergmann also pointed to the fact that Greenberg, as a partner at KPMG, was prohibited from helping non-clients. Finally, Bergmann highlighted the direction of the relationship, stating that he asked Greenberg for help, thus making it impossible for Greenberg to have "promoted" anything to him.

Second, Bergmann maintained that KPMG also was not a person described in Section 6700(a)(2) because it did not knowingly provide any false or fraudulent statements concerning the organization or sale of the 2000 transaction or the 2001 transaction. Bergmann offered many ideas in this regard. He stated, for instance, that neither KPMG nor Greenberg personally made any statements whatsoever regarding the relevant transactions.

Bergmann then explained that KPMG did not cause another person to make any statements because Corbin, who made the only statements in the form of a tax opinion, was an independent accountant hired by Bergmann. Additionally, even if the statements in Corbin's tax opinion were materially false or fraudulent, Bergmann suggested that KPMG had no actual or constructive knowledge of such statements because KPMG never reviewed any version of the opinion and never received a copy of the final opinion.

Bergmann also raised a timing issue, explaining that Section 6700(a)(2) requires that the troublesome statement be made "in connection with" the organization or sale of a tax shelter, and here Corbin did not issue his tax opinions until months *after* the 2000 transaction and the 2001 transaction had occurred. Since the tax opinions were not furnished contemporaneously with the SOS transactions, reasoned Bergmann, the statements in such opinions could not have been made "in connection with" such transactions, and the express language of Section 6700(a)(2) would not apply.

Bergmann raised yet another interesting argument, which was predicated on a concession by the IRS. The Service admitted—inadvertently, one would assume—that Bergmann's 2001 Form 1040 was not fraudulent. Bergmann essentially argued that the IRS should be precluded from taking the position that the statements in the tax opinion from Corbin were false or fraudulent when the IRS had already conceded that the end-product based on such statements (i.e., Bergmann's original 2001 Form 1040) was not fraudulent.

Third, Bergmann lobbied against what he saw as inconsistencies by the IRS. Specifically, the Service conceded that it initiated an investigation of KPMG for alleged violations of Section 6700 and other tax provisions, yet no penalties were asserted with respect to the 2000 transaction, 2001 transaction, or any other SOS-type transaction. Bergmann asked the Tax Court to characterize this non-imposition of penalties against KPMG as evidence that it was not, indeed, "a person described in section 6700(a)." Taking this a step further, Bergmann argued that it would be paradoxical for the Tax Court to conclude that KPMG was not a tax shelter promoter for purposes of Section 6700 penalties, but was "described in section 6700(a)" for purposes of determining whether Bergmann's 2001 Form 1040X was a QAR.

The IRS summonses lacked sufficient specificity. Bergmann introduced another line of attack, this one focusing on a different portion of the QAR Regulations. According to Reg. 1.6664-2(c)(3)(ii),¹² the 2001 Form 1040X filed by Bergmann on 3/15/04 would be considered a QAR if it was filed before "[t]he time any person described in section 6700(a) [possibly KPMG] is first contacted by the Internal Revenue Service concerning an examination of an activity described in section 6700(a) with respect to which [Bergmann] claimed any tax benefit on the [original 2001 Form 1040] directly or indirectly through an entity, plan or arrangement described in section 6700(a)(1)(A)...." (Emphasis added.)

Citing the italicized language above and a federal district court decision (*Sala*, 101 AFTR 2d 2008-1843, 552 F Supp 2d 1167 (DC Colo., 2008), *rev'd on another issue* 106 AFTR 2d 2010-5406, 613 F3d 1249 (CA-10, 2010)), Bergmann argued that the two summonses issued by the IRS on 3/19/02 were simply off target. The summons specifically stated that they pertained to the potential liability of KPMG under Section 6700 and other statutes, not to an "examination" of Bergmann's 2000 transaction and 2001 transaction. Indeed, the Service's examination of Bergmann's returns did not commence until approximately three years later, on 4/12/05. Bergmann argued, in short, that the summonses did not trigger Reg. 1.6664-2(c)(3)(ii) because they concerned the alleged promoter, KPMG, not the taxpayer, Bergmann.

Bergmann also contended that at least one of the IRS summonses did not apply to the 2000 transaction and the 2001 transaction. The Notice 2000-44 summons demanded that KPMG remit documents and information about transactions that were the same as or similar to the one described in Notice 2000-44. According to Bergmann, Notice 2000-44 dealt with transactions whereby partnership interests were given a high basis and then non-economic losses were generated on the sale of such interests. Bergmann concluded that since his 2001 transaction did not involve a partnership or a loss resulting from an interest therein, the Notice 2000-44 summons had no application and did not serve as an impediment to filing a QAR.

Main arguments presented by the IRS. The Service presented five arguments supporting its position that Bergmann's 2001 Form 1040X was not a QAR.

The IRS notices to KPMG barred QAR status. The Service underscored the various written communications it sent to KPMG, including the letter in September 2001 announcing the start of an investigation concerning tax shelter registration, the letter to KPMG's counsel on 2/2/02 stating that the Service's investigation covered "all tax shelter activities," and the two summonses issued on 3/19/02. The IRS argued that these documents were broadly worded and applied regardless of whether KPMG got paid for the related work. Moreover, the Service contended that the tax-shelter-related actions by Greenberg were similar for both KPMG clients and partners, such that the multiple notices pertained to Bergmann's 2000 transaction and 2001 transaction.

Applying the notices to all KPMG's tax-shelter-related activities advanced the goals of the QAR Regulations. The QAR Regulations have been modified several times, with each rendition making it more difficult for a Form 1040X to meet the eligibility requirements. The Preamble to the version of Reg. 1.6664-2(c)(3)(ii) that was in effect during 2001, the year at issue in *Bergmann*, was devoid of commentary about QARs. The Temporary Regulations issued in 2005, however, contained the following background:

"These provisions are intended to encourage voluntary compliance by permitting taxpayers to avoid accuracy-related penalties by filing an amended return before the IRS begins an investigation of the taxpayer or the promoter of a transaction in which the taxpayer participated."¹³

The Service reasoned that the purpose of the QAR Regulations was to give taxpayers who engaged in tax shelters an incentive to voluntarily disclose the transactions to the IRS in exchange for a benefit—the opportunity to dodge accuracy-related penalties. The Regulations also were designed, said the IRS, to discourage taxpayers from playing the "audit lottery."

As partners in KPMG, the IRS suggested, it was likely that both Bergmann and Greenberg had direct knowledge that the Service was investigating KPMG's tax shelter activities and that, through such investigation, the IRS would discover the SOS-like transactions, including Bergmann's 2000 transaction and 2001 transaction. Consequently, theorized the IRS, the filing of the 2001 Form 1040X after the start of the Service's investigation of KPMG was not the type of "voluntary" taxpayer action that the QAR Regulations were intended to reward.

IRS was not required to assert penalties against KPMG. The Service argued that, under the express language of the QAR Regulations, it was not required to prove that the person contacted with respect to the Section 6700 investigation (i.e., KPMG) actually violated that provision. Rather, IRS said, the Regulations mandate only that the Service make contact concerning an investigation of a tax-shelter activity. The IRS also alluded to the Preamble to the QAR Regulations,¹⁴ first issued approximately one year after Bergmann filed his 2001 Form 1040X, which explained the following:

"These temporary regulations also clarify the existing rules applicable to qualified amended returns. Temporary regulation §1.6664-2T(c)(3)(i)(B) clarifies that the period for filing a qualified amended return terminates on the date the IRS first contacts a person concerning an examination under section 6700, regardless of whether the IRS ultimately establishes that such person violated section 6700." (Emphasis added.)

Citing judicial precedent, the IRS argued that the preceding constituted a clarification of existing law, not a substantive change. Accordingly, it should be applicable to conduct, like Bergmann's, that occurred before it was promulgated.

The IRS summonses had sufficient specificity. As explained above, Reg. 1.6664-2(c)(3)(ii) provided that the 2001 Form 1040X filed by Bergmann on 3/15/04 would be considered a QAR if it was filed before "[t]he time any person described in section 6700(a) [possibly KPMG] is first contacted by the Internal Revenue Service concerning an examination of an activity described in section 6700(a) with respect to which [Bergmann] claimed any tax benefit on the [original 2001 Form 1040] directly or indirectly through an entity, plan or arrangement described in section 6700(a)(1)(A)...."¹⁵

Bergmann contended that the two summonses issued to KPMG approximately two years before he filed his 2001 Form 1040 did not satisfy Reg. 1.6664-2(c)(3)(ii) because their failure to specifically name the 2000 transaction, the 2001 transaction, or any SOS-like transaction rendered them too vague. Predictably, the Service took the opposite approach, arguing that the summonses issued to KPMG sufficed to trigger Reg. 1.6664-2(c)(3)(ii) as long as they merely named the "type" of transactions in which Bergmann engaged. In this case, suggested the IRS, the summons covered "all tax shelter activities" of KPMG, of which SOS-like transactions were a part.

KPMG was a "person described in section 6700(a)." With respect to Section 6700(a)(1), the IRS noted that the parties stipulated that Greenberg had breached this provision. It then contended that Greenberg, as a partner in KPMG, was acting on KPMG's behalf when

he organized the overall strategy for the SOS transactions, arranged to have the necessary parties participate, and coordinated with the law firm, LGD, to ensure that all the transactions had been properly implemented.

The IRS suggested that the evidence favored the conclusion that Greenberg was acting within his scope of authority in his dealings with Bergmann: KPMG hired Greenberg to be part of Stratecon, the SOS transactions in which KPMG partners participated were the same as or substantially similar to those promoted to KPMG clients, and Greenberg arranged for LGD and others to participate. If the KPMG partners had paid their own firm for the services, there would be no doubt that Section 6700(a)(1) applied, IRS argued.

Therefore, allowing KPMG to circumvent the rule merely because Greenberg ignored an internal rule by not collecting a fee would be contrary to the spirit of the QAR Regulations. The IRS, invoking a constitutional law concept, urged the Tax Court to find that "sufficient nexus" existed between KPMG and the transactions of its partners, including Bergmann, to make KPMG a "person described in section 6700(a)."

The Service's arguments regarding Section 6700(a)(2) were more extensive. The IRS stated that Corbin's tax opinions contained false or fraudulent statements about the tax benefits that Bergmann would obtain by engaging in the 2000 transaction and the 2001 transaction. It suggested that while each tax opinion by Corbin appeared to be an independent analysis, it was, for all practical purposes, simply a reproduction of an earlier opinion issued by Greenberg.

The arguments seem to weaken from there. For instance, the Service maintained that the tax opinions were false because their purported aim was to analyze the federal income tax effects of the 2000 transaction and the 2001 transaction, yet Bergmann testified at trial that the sole reason for securing the opinions was protection against penalties in case of an IRS audit. The Service also argued that the opinions were "false" because the IRS, citing assorted judicial precedent, disagreed with Corbin's conclusions regarding economic substance, business purpose, and profit motive.

Having thus satisfied itself that Corbin's opinions contained false statements, the IRS argued that KPMG, through its partner Greenberg, knew or had reason to know of the false statements. The Service highlighted the fact that Greenberg was a sophisticated tax professional with over 15 years of experience at large accounting firms. Finally, the IRS argued that KPMG, thanks to Bergmann, "caused" Corbin to issue the opinions because Greenberg supposedly arranged this for various KPMG partners, including Bergmann.

The Tax Court

The briefing of the parties in *Bergmann* was extensive, while the opinion of the Tax Court was relatively narrow. The relevant facts of the case, of course, were explained. Thereafter, emphasizing that it was addressing a novel issue, the Tax Court stated that it had been tasked with deciding "for the first time" whether the IRS must assert a tax-shelter-promoter penalty under Section 6700 (against KPMG in this case) in order to terminate the opportunity for a taxpayer, like Bergmann, to file a QAR under Reg. 1.6664-2(c)(3)(ii). The court dispensed with this issue with little fanfare, explaining that "[w]e do not find any penalty requirement in [Reg. 1.6664-2(c)(3)(ii), so the IRS] need not have found KPMG liable for the promoter penalty under section 6700."

The Tax Court then turned to the main issue of whether the period to file a QAR terminated for Bergmann when the IRS first contacted KPMG about the tax-shelter-promoter investigation, if such investigation covered either the 2000 transaction or the 2001 transaction. The court noted that the Service served KPMG with two summonses on 3/19/02, the summonses explicitly stated that they concerned the liability of KPMG under Section 6700, and Bergmann filed his 2001 Form 1040X on 3/15/04. Based on these three events, the Tax Court held that KPMG was indeed under a tax-shelter-promoter investigation before Bergmann filed the 2001 Form 1040X.

With that decided, the Tax Court next examined the issue of whether the Service's investigation of KPMG covered the 2000 transaction or the 2001 transaction. To make that determination, the Tax Court indicated that it must first decide whether Greenberg's acts could be attributed to KPMG. The parties ultimately agreed, after initial disputes and specific briefing on the issue, that California agency and partnership law should govern. California law dictates that an act by a partner which apparently is within the usual course of business is binding on the partnership, unless the partner had no authority to act *and* the person dealing with the partner knew that the partner had no authority to act.

The apparent scope of a partnership business depends on the conduct of the partners and the partnership. Consequently, the Tax Court looked to KPMG's usual course of business, on which the behavior of the Stratecon group and Greenberg had a bearing. The court identified the following items:

- (1) Stratecon's purpose was to design, promote, and implement tax strategies, including transactions like SOS.
- (2) Greenberg was hired specifically to work in Stratecon.
- (3) Greenberg regularly organized and coordinated these types of transactions for KPMG clients and at least seven KPMG partners during the relevant years.
- (4) Greenberg performed substantially the same acts for both clients and partners.

Based on the foregoing, the Tax Court held that the normal scope of KPMG's business included organizing and coordinating transactions like SOS for clients and partners.

The court then went one step further, analyzing whether the specific arrangements at issue, the 2000 transaction and the 2001 transaction, were within the scope of KPMG's business. The Tax Court, leaving no room for doubt, stated: "Simply put, they were." This determination was based on two facts. First, the 2000 transaction and the 2001 transaction were similar to or the same as the transactions that Greenberg promoted to KPMG clients and partners. Second, Greenberg assisted Bergmann during the period that he worked in the Stratecon group.

Finally, the Tax Court considered whether KPMG had limited Greenberg's apparent authority to act on behalf of the partnership. The Tax Court, underscoring that Bergmann relied solely on his "self-serving" testimony to advance the argument that Greenberg had exceeded his authority, concluded that no limitation existed on Greenberg's power. In doing so, the court explained that Bergmann did not introduce into evidence a partnership or other agreement restricting Greenberg's authority. Moreover, Greenberg coordinated SOS-type transactions for six other KPMG partners and nothing in the record proved that KPMG objected to Greenberg's behavior.

After determining that Greenberg was acting as KPMG's agent with respect to the 2000 transaction and the 2001 transaction, and that Greenberg's apparent authority to act on behalf of KPMG had not been limited in any way, the Tax Court addressed the final issue: Whether at least one of the summonses issued to KPMG by the IRS on 3/19/02 covered the 2000 transaction or the 2001 transaction.

Bergmann, citing a recent federal district court case, argued that the QAR Regulations (i.e., Reg. 1.6664-2(c)(3)(ii)) should be construed narrowly, such that a summons does not terminate a taxpayer's period for filing a QAR unless it specifically identifies the activity at issue. The Service argued that the QAR Regulations must be broadly interpreted, allowing a summons to adequately cover a transaction if it merely refers to the "type" of transaction in which the taxpayer engaged.

The Tax Court, clarifying that it was unencumbered by a nonbinding federal court decision, agreed with the Service's position. The court held as follows: "[The IRS] argues that a summons will cover a transaction if it refers to (at least) the type of transaction that the taxpayer participated in.... We agree. Petitioners read [Reg. 1.6664-2(c)(3)(ii)] too narrowly. We agree with [the IRS] that a summons will cover a transaction if it refers to the type of transaction in which the taxpayer participated."

The court then explained that the Notice 2000-44 summons referred to all transactions that were the same as or similar to the transaction described by the IRS in its Notice 2000-44, and the 2000 transaction fell into this category. It also stated that Bergmann reasonably could have concluded that the Service would discover the 2000 transaction once the IRS served the Notice 2000-44 summons on KPMG. Therefore, disclosure by Bergmann to the IRS after the issuance of the Notice 2000-44 summons would not have been "voluntary."

The Tax Court ultimately ruled that the 2001 Form 1040X that Bergmann filed on 3/15/04 was not a QAR because it was submitted after the IRS issued the Notice 2000-44 summons. Consequently, the additional tax liability shown on the 2001 Form 1040X was not counted as the amount of tax shown on the original 2001 Form 1040, and Bergmann thus had an "underpayment" on which the IRS could assert a penalty.

WHY *BERGMANN* IS IMPORTANT

Tax litigation often tends to be complex and dense. Moreover, if one lacks the necessary context about the issues in dispute, grasping the importance of a case, or comprehending how the case might be detrimental or beneficial to other taxpayers, can be a serious challenge. Thus, it is worthwhile to take a moment to identify some of the reasons why *Bergmann* is important.

Case of First Impression on Two Issues

All cases that address novel issues are important, and *Bergmann* is no exception. The Tax Court tackled two new items. First, the court expressly stated that it was deciding "for the first time" whether the IRS was obligated to assess against KPMG a tax-shelter-promoter penalty under Section 6700 in order to terminate Bergmann's time period for filing a QAR under Reg. 1.6664-2(c)(3)(ii). The Tax Court swiftly resolved this issue, holding that "[w]e do not find any penalty requirement" in the QAR Regulations.

Second, and perhaps more significant, the Tax Court grappled with the concept of just how specific an IRS summons must be to satisfy the QAR Regulations. To appreciate this decision, one must be aware of the existing precedent, *Sala*. There, the taxpayer engaged in a foreign currency investment referred to as the "Deerhurst Program."

The district court in *Sala* held that there was no tax "underpayment." It went on to explain that, even if the taxpayer had underpaid his taxes on his original Form 1040, the IRS would not be entitled to any penalty if the taxpayer filed a QAR. The Service argued that the taxpayer's Form 1040X was not a QAR because KPMG was under investigation for promoter-related activities before the taxpayer filed it. The district court acknowledged that KPMG was under investigation for promoting abusive tax shelters, but observed that the investigation did not specifically include the transaction in which the taxpayer engaged, i.e., the Deerhurst Program:

"The relevant inquiry, however, is not whether KPMG was contacted regarding transactions similar to Deerhurst, but whether KPMG was contacted regarding Deerhurst itself. Under [the QAR Regulations], an amended return is not 'qualified' if filed after a 'person' described in 26 U.S.C. §6700 is contacted regarding a transaction described in §6700 'with respect to which the taxpayer claimed any tax benefit.' The only transaction with respect to which Sala 'claimed any tax benefit' in 2000 was the Deerhurst Program. *No evidence was presented at trial showing KPMG was contacted regarding Deerhurst prior to [the date on which Sala filed the Form 1040X]. Accordingly, the Government fails to make a prima facie case that penalties should apply.*" (Emphasis added.)

The Tax Court, of course, was aware of the precedent, but clarified in *Bergmann* that "[d]ecisions of U.S. District Courts are not binding on this Court.... We are therefore not bound by the decision in *Sala*." As explained in more detail above, the Tax Court went on to issue an unprecedented ruling that "a summons will cover a transaction [for purposes of the QAR Regulations] if it refers to *the type of transaction* in which the taxpayer participated." (Emphasis added.) In *Bergmann*, the Notice 2000-44 summons issued to KPMG mentioned all transactions that were the same as or similar to the transaction described in Notice 2000-44, and, in the Tax Court's view, the 2000 transaction fell into this category.

Issues Not Addressed by the Tax Court

Interesting issues raised by the parties sometimes do not find their way into Tax Court opinions because they are not fundamental to the outcome. They are often noteworthy, though. *Bergmann* features at least one such issue, which is bound to pique the interest of tax-procedure enthusiasts.

Much of *Bergmann* focuses on Reg. 1.6664-2(c)(3)(ii), but another portion of the QAR Regulations plays a role, albeit minor. Reg. 1.6664-2(c)(2) discusses the "effects" of filing a QAR, explaining that "[t]he amount shown as the tax by the taxpayer on his return includes an amount shown as additional tax on a [QAR], *except that such amount is not included if it relates to a fraudulent position on the original return.*" (Emphasis added.)

In other words, a taxpayer cannot remedy the filing of a fraudulent original Form 1040 by later submitting a Form 1040X; the benefits of the QAR Regulations are only granted to taxpayers whose original underpayments were due to inaccuracies, not intentional wrongdoing. At various points in *Bergmann*, the IRS agreed to the broad statement that Bergmann's 2001 Form 1040X "satisfies *all* the requirements set forth in the [QAR] regulations *except* the requirement that the return be filed before [the IRS] contacts 'a person described in Section 6700(a) .'" ¹⁶

Presumably, the Service intended to clarify *only* that it was not pursuing any grounds under Reg. 1.6664-2(c)(3) other than Reg. 1.6664-2(c)(3)(ii) when it made that concession. The IRS may not have thought this through. Bergmann seized the opportunity to make the following argument in his briefs to the Tax Court: The IRS agrees that Bergmann's original 2001 Form 1040 was not fraudulent, yet argues that the statements in Corbin's tax opinion on which Bergmann based his original 2001 Form 1040 are false or fraudulent. This seems contradictory, does it not?

The IRS countered this attack with three ideas. First, the Service maintained that the QAR Regulations, including Reg. 1.6664-2(c)(2), deal with the conduct of the taxpayer, whereas Section 6700 concerns the actions of the tax shelter promoter. Thus, a taxpayer has

not committed fraud if he relies, in good faith, on false or fraudulent statements made by a promoter. Second, Bergmann's original 2001 Form 1040 does not contain any "statements" described in Section 6700(a)(2), which means that the IRS has not conceded that any "statements" are not fraudulent. Finally, the IRS pointed out that Section 6700(a)(2) covers both false *and* fraudulent statements. Thus, even if Bergmann were correct in that the IRS somehow conceded that the tax opinions did not contain any fraudulent statements, they still could have false ones.

Much to the dismay of tax-procedure fans, the Tax Court did not address the preceding issue in its opinion.

IRS and the Scope of the QAR Regulations

Savvy taxpayers and tax professionals understand that the Service and many states share taxpayer information in an effort to increase global tax compliance. Accordingly, when a taxpayer participates in an amnesty program, such as one of the many "voluntary disclosure initiatives" being offered by various states, he ordinarily anticipates that the information provided for that purpose will eventually end up in the Service's possession. Logic dictates, then, that taxpayers will attempt to resolve both their state and federal tax noncompliance concurrently, presumably by filing Forms 1040X and their state counterparts as part of the same overall process.

One portion of the QAR Regulations not addressed in *Bergmann*, Reg. 1.6664-2(c)(3)(i), states that a Form 1040X will not be considered a QAR unless the taxpayer files it before "[t]he date the taxpayer is first contacted by the Internal Revenue Service (IRS) concerning any examination (including a criminal investigation) with respect to the return...." One might assume, therefore, that a taxpayer participating in a state voluntary disclosure initiative who also files Forms 1040X to ensure full compliance would be granted QAR treatment, provided that the IRS had not commenced an examination or investigation by that time. Nevertheless, this is not the position that the IRS took in its briefing in *Bergmann*:

"Mr. Bergmann's own testimony establishes that petitioners engaged in the 'wait-and-see' tactic the Service hoped to discourage by promulgating the [QAR] regulation. He stated that the only reason petitioners amended their 2001 return was because he knew that, due to the information sharing agreement between the Service and California, the Service would find out about this tax shelter transaction when petitioners amended their state income tax return to take advantage of a state amnesty program. This is exactly the type of conduct the Service does not want to reward by allowing penalty relief [under the QAR regulations]." ¹⁷

The fact that the Tax Court did not feel it necessary to address this issue in order to render its decision in *Bergmann* in no way diminishes the issue's importance. If the Service's arguments in *Bergmann* represent a broader, agency-wide policy as opposed to the stance of two maverick SBSE attorneys, it should cause significant concern to taxpayers and state taxing agencies. Indeed, the IRS seems to be trying to add a new limitation in the QAR Regulations without adhering to the publish-comment-hearing requirement, and such limitation would likely quell the willingness of taxpayers to participate in state disclosure programs.

No Gross Valuation Misstatement Penalty

Bergmann also is interesting because of its secondary issue, valuation penalties. Since the Tax Court decided that Bergmann did not file a QAR (and thus there was a tax "underpayment" on his original 2001 Form 1040), it had to determine the proper penalty.

Under Section 6662(h), a "gross valuation misstatement" exists if, among other things, the value or adjusted basis of any property claimed on certain tax returns is 200% or more of the correct value or adjusted basis. The penalty in such cases increases from 20% to 40% of the tax "underpayment." Specifically, Section 6662(h)(1) states that "[t]o the extent that a portion of the underpayment ... is attributable to one or more gross valuation misstatements," the higher penalty applies.

To review the relevant facts, Bergmann stipulated before trial that he was not entitled to the tax deductions related to the 2000 transaction and the 2001 transaction. In fact, he had filed the 2001 Form 1040X and paid the corresponding taxes long ago. In Notice 2000-44 (which the IRS and the Tax Court said applied in *Bergmann*), the Service had identified multiple reasons for disallowance, including lack of economic substance, Section 752, Reg. 1.702-1 or other anti-abuse rules, and Section 165(c)(2). Bergmann took the position that he decided to concede the tax-deduction issue on grounds *other than* the value or adjusted basis of the property at issue.

Bergmann turned to favorable precedent to battle this issue, including, but not limited to, *Keller*, 103 AFTR 2d 2009-1053, 556 F3d 1056 (CA-9, 2009), *rev'g* TC Memo 2006-131, RIA TC Memo ¶2006-131. In that case, the Ninth Circuit decided the issue of when a

tax "underpayment" is attributable to a valuation misstatement and thus subject to increased penalties. In *Keller*, the taxpayer and the IRS stipulated before trial that the taxpayer was not entitled to any deductions based on the transaction at issue. The taxpayer then argued before the court that the underpayment was not "attributable to" the valuation misstatement because the parties had stipulated that the taxpayer was entitled to no deduction whatsoever, as opposed to a reduced deduction.¹⁸

The Tax Court in *Bergmann* recognized that it had previously held that when the IRS asserts a legal ground other than the value or adjusted basis of property for completely disallowing a deduction or credit and the taxpayer concedes on such other ground, then any underpayment resulting from the concession is not attributable to a "gross valuation misstatement." Moreover, the Tax Court indicated that it had extended this notion to situations where the taxpayer does not state the specific ground for the concession, provided that the IRS has asserted some grounds for disallowance other than value or adjusted basis.

Here, observed the Tax Court, *Bergmann* conceded the tax liability before trial on legal grounds other than the value or adjusted basis of property because the Service argued that the 2000 transaction and the 2001 transaction lacked economic substance and were engaged in solely for tax purposes. The Tax Court, recognizing its obligation to follow applicable precedent, held in favor of *Bergmann* by upholding only the smaller, 20% penalty on the "underpayment" on *Bergmann's* original 2001 Form 1040.

Outcome Under the Current Regulations

Bergmann also has appeal because it leads to an analysis of the evolving Regulations. *Bergman* filed his 2001 Form 1040X on 3/15/04. Accordingly, the Regulations governing his case were those promulgated in 1991.¹⁹ That version of the Regulations contained the language in Reg. 1.6664-2(c)(3)(ii) that largely fueled the dispute in *Bergmann*. It stated that to be considered a QAR a Form 1040X must be filed before:

"The time any person described in section 6700(a) ... is first contacted by the Internal Revenue Service concerning an examination of an activity described in section 6700(a) with respect to which the taxpayer claimed any tax benefit on the return directly or indirectly through an entity, plan or arrangement described in section 6700(a)(1)(A)...."

Things began to change, though, in May 2004 when the IRS issued Notice 2004-38, 2004-1 CB 949, indicating its intention of issuing new Regulations to modify the definition of a QAR. According to Notice 2004-38, the primary reason for issuing the new Regulations was to provide that the period for filing a QAR terminates when (1) the IRS serves a John Doe summons with respect to a taxpayer's liability, and (2) when the IRS contacts a promoter, organizer, or material advisor concerning a "listed transaction" for which the taxpayer has claimed a tax benefit.

The Regulations, introduced in temporary form in March 2005 and finalized in January 2007, contain the two promised limitations. They also feature a revamped version of the main provision at issue in *Bergmann*, Reg. 1.6664-2(c)(3)(ii). The new iteration, now Reg. 1.6664-2(c)(3)(i)(B), states that a Form 1040X must be filed before the following in order to be deemed a QAR:

"The date any person is first contacted by the IRS concerning an examination of that person under section 6700 (relating to the penalty for promoting abusive tax shelters) for an activity with respect to which the taxpayer claimed any tax benefit on the return directly or indirectly through the entity, plan or arrangement described in section 6700(a)(1)(A)...."²⁰

Augmenting this, the Preamble to the Temporary Regulations stated that revised Reg. 1.6664-2(c)(3)(i)(B) was designed to clarify that the period for filing a QAR ends when the IRS contacts a person, like KPMG, about potential tax-shelter-promoter liability under Section 6700, "regardless of whether the IRS ultimately establishes that such person violated section 6700."²¹

The new Regulations may have resolved some of the issues at the forefront in *Bergmann*, but room for disputes over QARs certainly remains.

CONCLUSION

Most taxpayers have experienced the "oh shoot" moment at least once, the instant when panic surges about positions taken on a previous tax return. The QAR can be a powerful remedy in these situations, but only if the taxpayer or his advisor is aware of the QAR rules. Also, as *Bergmann* demonstrates, even if one knows of the existence of the QAR rules, it is critical to follow their evolution because changes continue to occur through Regulations and precedent.

Practice Notes

Bergmann demonstrates that practitioners seeking to use a QAR to reduce a client's potential exposure to accuracy-related penalties must determine not only the actions that the IRS has taken against the client, but also those against the persons who organized, sold, or gave advice in connection with a supposed "tax shelter." *Bergmann* also shows that the QAR Regulations may be narrowly construed, thereby making a thorough analysis of the evolving Regulations and related judicial precedent a must.

1

Sections 6662(a) and (b).

2

Section 6664(a); Reg. 1.6664-2(a) . The technical definition of "underpayment" is considerably more complicated, but a simplified definition suffices to make the critical points in this article without unnecessarily confusing the reader. The underpayment and QAR rules are not limited to individual taxpayers; the example of an individual, male taxpayer is used throughout the article for the sake of simplicity and clarity.

3

Section 6664(c)(1). Penalties would not apply if the underpayment was due to "reasonable cause" and the taxpayer acted in good faith.

4

Reg. 1.6664-2(c)(2).

5

Reg. 1.6664-2(c)(3) (as promulgated by TD 8381 , 12/30/91).

6

Id.

7

A person also could satisfy the second criteria by making or furnishing or causing another person to make or furnish (in connection with an entity, plan, or arrangement) a gross valuation overstatement as to any material matter.

8

The facts and arguments described herein are derived from various sources related to *Bergmann*, 137 TC No 10, Tax Ct Rep Dec (RIA) 137.10, 2011 WL 4809047 , including the Pre-Trial Memorandum for Petitioners, Pre-Trial Memorandum for Respondent, Petitioners' Post-Trial Brief, Opening Brief for Respondent, Reply Brief for Petitioners, Reply Brief for Respondent, Petitioners' Supplemental Brief Regarding Choice of Law Issue, and Supplemental Brief for Respondent. The author has copies of all these documents.

9

The original 2001 Form 1040 was a joint return filed with the spouse.

10

As promulgated in 1991 by TD 8381 , *supra* note 5.

11

As with the critical facts in the *Bergmann* case, the arguments described in this section of the article are derived from various sources, including the Pre-Trial Memorandum for Petitioners, Pre-Trial Memorandum for Respondent, Petitioners' Post-Trial Brief, Opening Brief for Respondent, Reply Brief for Petitioners, Reply Brief for Respondent, Petitioners' Supplemental Brief Regarding Choice of Law Issue, and Supplemental Brief for Respondent.

12

As promulgated in 1991 by TD 8381 , *supra* note 5.

13

TD 9186, 3/2/05.

14

Id.

15

As promulgated in 1991 by TD 8381 , *supra* note 5.

16

Pre-Trial Memorandum for Respondent, filed with the U.S. Tax Court on 10/12/10, page 12 (emphasis added); Opening Brief for

Respondent, filed with the U.S. Tax Court on 1/18/11, page 43 (emphasis added).

¹⁷

Reply Brief by Respondent, filed with the U.S. Tax Court on 2/15/11, page 39.

¹⁸

Bergmann, a resident of California, also cited the Golsen rule, which holds that the Tax Court will follow Ninth Circuit decisions in cases that would be appealable to the Ninth Circuit.

¹⁹

See note 5, *supra*.

²⁰

As promulgated by TD 9309 , 1/8/07.

²¹

TD 9186, 3/2/05.