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| Qualified Offers and the Recovery ofAdministrative and Litigation Costs From the IRS |
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A panel presentation with William Taggart, Larry A. Campagna, and Todd Welty

UCLA 2010 Annual Tax Controversy Institute

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# Introduction

Taxpayers and taxpayers’ counsel may be able to proactively fit within the net worth requirements set forth in 28 U.S.C. § 2412(d)(1)(B), which sets forth the standard applicable to both recovery of litigation costs and shifting the burden of proof to the government in tax cases. For example, a taxpayer may be able to successfully fit within net worth requirements by making distributions at any time before the date the case is filed. The following discussion provides a summary of this taxpayer position in recent litigation, the government’s opposition to this position, and the taxpayer’s appropriate—and successful—reply. In addition, relevant portions of the court’s holding and the case law the Government relied upon is also attached for the convenience of the reader. This discussion contains excerpts from Southgate Master Fund, LLC v. United States, 651 F. Supp. 2d 596 (N.D. Tex. 2009).

# Taxpayer Position

The “Net Worth Requirement” of section 7491(a)(2)(C)[[1]](#footnote-1) requires only that a partnership described in 28 U.S.C. § 2412(d)(1)(B) had a net worth of less than $7 million at the time the civil action was filed.[[2]](#footnote-2) Where the government does not dispute that taxpayer had a net worth of less than $7 million on the date the case was filed, taxpayer meets the net worth requirement of section 7491(a)(2)(C).

# The Government’s Argument

In Southgate, the Government argued that the taxpayer could not shift the burden of proof to the United States because the taxpayer did not meet the net worth requirement of section 7491(a)(2)(C).[[3]](#footnote-3) The Government did not dispute Southgate's assertion that its net worth was approximately $3.9 million when it filed a lawsuit on December 19, 2006.[[4]](#footnote-4) Instead, the Government contended that Southgate improperly manipulated its net worth through a $55 million distribution on October 13, 2006.[[5]](#footnote-5) It argued the $55 million must be included in Southgate's net worth figure, placing it well above the $7 million threshold.[[6]](#footnote-6)

In support of its argument, the Government claimed that the courts in Estate of Woll and Miller held that assets in the taxpayer’s control, but distributed prior to filing suit, must be included for purposes of determining the taxpayer’s net worth. Thus, according to the Government, the distribution by the taxpayer prior to filing suit, should have been included for purposes of determining the taxpayer’s net worth.

Specifically, the Government’s post-trial response brief contained the following argument:

Plaintiff asserts Southgate had a net worth of approximately $3.9 million on December 18, 2006, the date of filing of this lawsuit. Plaintiff, however, manipulated Southgate’s net worth immediately prior to this lawsuit being filed against the United States. In fact, Montgomery testified that immediately prior to the filing of this lawsuit, and after issuance of the FPAA by the IRS on October 13, 2006, Southgate’s financial records reflect a $55 million distribution to Beal in GNMAs and cash. [citation omitted]. Without this distribution to Beal, Southgate would flunk the $7 million net worth requirement under § 7491(a)(2)(C) and 28 U.S.C. § 2412(d)(2)(B).

In Estate of Woll v. United States, 44 F.3d 464 (7th Cir. 1994) and Miller v. United States, 926 F. Supp. 642, 644-45 (N.D. Ohio 1996), courts held that assets in the taxpayer’s control but distributed prior to filing suit, must be included for purposes of determining the taxpayer’s net worth calculation under Equal Access to Justice Act’s attorney fee provision, 28 U.S.C. § 2412(d)(2)(B), which is the same net worth provision that § 7491(a)(2)(C) utilizes. Under these authorities, the $55 million distribution to Beal immediately prior to Plaintiff filing suit must be included, thus causing Southgate to fail the $7 million net worth requirement under § 7491(a)(2)(C).[[7]](#footnote-7)

# Taxpayer Response

The two cases cited by the Government, Estate of Woll and Miller, relate only to calculating the net worth of estates, not the net worth of a partnership.[[8]](#footnote-8) Further, the cited cases predate subsequent legislation that established special rules for estates and trusts, but not partnerships or other business entities.

## 1. The Government’s Reliance on Estate of Woll and Miller is Misplaced.

28 U.S.C. § 2412(d)(2)(B) places net worth limitations on individuals and any “unincorporated business, or any partnership, corporation, association, unit of local government, or organization” but is lacking a specific limitation for estates. In both Estate of Woll and Miller the courts were attempting to apply the net worth limitation for an individual to an estate. The Seventh Circuit reasoned that “[a]n estate is a somewhat different creature . . . an estate is merely the sum total of a deceased person’s property, destined for distribution to others in accordance with either the decedent’s will or the state’s inheritance laws.”[[9]](#footnote-9) Thus the court determined that the net worth of an estate was to be determined as of the date of death, not as of the date the suit was filed.[[10]](#footnote-10) The court in Miller later specified that it was the practical net worth of the individual that mattered, only those assets over which the decedent retained complete control were to be included in the net worth calculation for the estate.[[11]](#footnote-11) Thus the Miller court limited the application of Estate of Woll by excluding assets over which the decedent had not retained control from the net worth calculation.

The courts in Estate of Woll and Miller had to analogize to the net worth limitation placed on individuals under 28 U.S.C. § 2412(d)(2)(B) because the statute did not expressly provide for a net worth calculation in the case of an estate. No court has ever applied this same distribution or control reasoning to a partnership or any other business entity. The statute in the case of a partnership is clear, the net worth limitation is to be determined as of the date the suit was filed.

## 2. Assets Distributed Prior to Filing Suit are Considered for Net Worth Calculations Only in the Case of an Estate or Trust.

Three years after Estate of Woll, the Taxpayer Relief Act of 1997 codified this special rule for estates and trusts.[[12]](#footnote-12) Section 7430(c)(4)(D) now states that the net worth limitation for estates “shall be determined as of the date of the decedent’s death” and for trusts “shall be determined as of the last day of the taxable year involved in the proceeding.” No such special rule was put in place for individuals, partnerships, or other business entities. Thus, under 28 U.S.C. § 2412(d)(1)(B) the net worth limitations for a partnership is determined “at the time the civil action was filed . . . .”[[13]](#footnote-13)

Congress could have also created a similar special rule for other entities under which assets distributed prior to filing suit would be considered for the net worth calculation. Congress created no such rule. Accordingly, the statute does not provide for an alternative net worth limitation for partnerships and one cannot be read into the statute.

# Court’s Findings In Southgate

In Southgate, the court concluded that the taxpayer’s net worth met the statutory requirement.[[14]](#footnote-14) In doing so, the court distinguished Estate of Woll and Miller and looked to the legislative history of the Act.

The court first analyzed Woll and Miller, rejecting the Government’s argument:

In Woll, however, the Seventh Circuit [sic] “unique nature and purpose of estates,” with the certainty that an estate's assets will dwindle over time, in “contrast to the vagarious ups and downs of individual and corporate wealth.” Woll, 44 F.3d at 468, 469. As noted in Miller, Congress's statement of purpose behind the [Act] was that the legislation would “serve as an ‘equalizer’ for those litigants who could otherwise not afford costs of litigation against the federal government.” Miller, 926 F. Supp. at 644 (citing National Truck Equip. v. Nat. Hwy. Safety Admin., 972 F.2d 669, 673 (6th Cir. 1992)). “When [a litigant has] the economic power to pursue litigation against the government without being deterred by the costs, the congressional purposes of the [Act] are undermined by an award to [that litigant].” National Truck, 972 F.2d at 674.[[15]](#footnote-15)

The court further looked to the legislative history:

The legislative history of the [Act], containing the burden-shifting provision at issue in this case, appears to express the inverse concern: seeking to rein in the IRS rather than simply empowering private litigants. See H. REP. NO. 105-599; see also 144 CONG. REC. S7722 (1998) (statement of Sen. Dodd) (“By shifting the burden of proof, this bill will require that the IRS prove its allegations with evidence. It will help ensure that the IRS exercises appropriate caution and consideration prior to commencing an enforcement action against any taxpayer.”) (emphasis added). Although the very inclusion of a net worth requirement demonstrates some legislative concern with the relative economic power of litigants, the overarching goals of the two acts and the facts at hand are not similar enough to counsel strict reliance on the cases cited by the Government.[[16]](#footnote-16)

Therefore, the court concluded that the taxpayer met requirements under section 7491(a) to shift the burden of proof to the Government, rejecting the Government's apparent equitable concerns and policy-based arguments, and granting the taxpayer’s motion to shift the burden of proof to the Government.

# Cases

United States Court of Appeals,
Seventh Circuit.

ESTATE OF Albert A. WOLL, by David WOLL, Co-Trustee of the Third Restatement of Intervivos Revocable Trust for the Benefit of Albert A. Woll, Plaintiff-Appellee,
v.
UNITED STATES of America, Defendant-Appellant.
No. 94-1192.

Argued Sept. 8, 1994.
Decided Dec. 30, 1994.
Rehearing and Suggestion for Rehearing En Banc Denied Jan. 30, 1995.

Federal estate tax refund suit was filed after the IRS rejected the estate's refund claim. The United States District Court for the Southern District of Indiana, Gene E. Brooks, J., ruled against government on merits of case and awarded estate fees and costs. United States appealed fee and cost award. The Court of Appeals, Ilana Diamond Rovner, Circuit Judge, held that: (1) $2 million net worth limitation on individuals entitled to recover fees under Equal Access to Justice Act applied, and (2) assets distributed before suit was commenced were included in estate's net worth calculation.

Reversed.

See also, 809 F.Supp. 643.

Judith A. Stewart, Office of the U.S. Atty., Indianapolis, IN, Gary R. Allen, Robert W. Metzler, Gilbert S. Rothenberg (argued), Karen A. Smith, Stephen T. Lyons, Dept. of Justice, Tax Div., Appellate Section, Washington, DC, for defendant-appellant.

Before COFFEY and ROVNER, Circuit Judges, and FOREMAN, District Judge.FN\*

FN\* The Honorable James L. Foreman, of the Southern District of Illinois, sitting by designation.

ILANA DIAMOND ROVNER, Circuit Judge.

After ruling against the government on the merits of a suit challenging the tax assessed against a decedent's estate, the district court concluded that the government's litigating position had not been substantially justified and that the estate was entitled to recover its attorneys' fees and costs. We hold that in determining an estate's eligibility to recover its fees and costs, a court must consider the net value of all assets in the estate, even those that were distributed in advance of suit. Here the record indicates that when distributed assets are included in the net worth determination, the estate is disqualified from recovering its litigation expenses. We therefore reverse the award of fees and costs.

## I. Facts

Albert Woll died testate on August 8, 1987. He was survived by three children and his second wife, Sarah G. Woll. His estate included the assets of two trusts, one a revocable trust established by Albert during his lifetime (the “Albert A. Woll Trust,” which we shall refer to as the “AWT”), and another that came into being upon the 1985 death of Albert's first wife, Pearl (the “Albert A. Woll Marital Trust,” which we shall refer to as the “PWT”), pursuant to the terms of a revocable trust she had established during her lifetime (the “Pearl Trust”). The terms of the PWT had made the principal and interest of that trust available to Albert for the remainder of his life, but provided that on his death, the balance after taxes be distributed in equal shares to the three children of Pearl and Albert. The AWT directed that Sarah be given the use of the home that she and Albert had shared for the remainder of her life and provided that Albert's personal effects be distributed to his children immediately.\*466 The remainder of the assets in the AWT trust estate were to be placed in the “Sarah G. Woll Qualified Terminable Interest Property Trust” (“SWT”) which would provide income to Sarah during her lifetime. Upon her death, the principal of the SWT would then be distributed to the children of Albert and Pearl in equal shares.

A dispute arose between Albert's estate and the IRS as to whether the taxes, debts, and administrative expenses chargeable to the estate should be paid by the PWT or the AWT. On the estate tax return filed with the IRS, the estate claimed a marital deduction for all property in the AWT that was to be distributed to the SWT. In calculating the amount of that deduction, the estate assumed that the PWT would pay any taxes and other expenses owed by Albert's estate. When it conducted an audit, however, the IRS concluded that the AWT should pay these items, an allocation that would have the effect of diminishing the amount of property remaining in the AWT for distribution to the SWT and, consequently, reducing substantially the size of the marital deduction that the estate could claim. By the IRS' reckoning, the estate owed an additional tax of $179,302.29 and interest of $73,758.95. The estate paid the assessment and, after its claim for a refund was rejected, filed this suit pursuant to 26 U.S.C. § 7422 and 28 U.S.C. § 1346(a)(1).

On cross-motions for summary judgment, the district court held for the estate. The court looked primarily to the provisions of the Pearl Trust to decide whether the PWT or AWT should be charged with the taxes and other expenses occasioned by Albert's death. The Pearl Trust dictated that upon the death of the survivor of Albert and Pearl, the assets remaining in the PWT would be distributed to their children. However, it also specified that PWT funds should be used to pay any taxes “which may be assessed as the result of the death of the primary beneficiary”-the primary beneficiary being Pearl. The district court construed these provisions to mean that any taxes occasioned by the distribution of the PWT assets to the children on Albert's death would be paid from the PWT itself (before the remainder was distributed to the children) rather than from any other asset in Albert's estate. Moreover, the court noted, once Pearl had died, these provisions became irrevocable; thus, the Trust's directive as to the payment of taxes could not be altered by anything that Albert might direct later. For that reason, the district court found it unnecessary to consider any of the provisions in the AWT and Albert's will relating to the payment of taxes. 809 F.Supp. 643, 645. Finally, although the Pearl Trust ostensibly authorized the payment of taxes only insofar as such taxes resulted from the death of the “primary beneficiary” of the Pearl Trust, the court found it unnecessary to decide whether “primary beneficiary” really meant Pearl alone (as the terms of the Pearl Trust suggested) or included Albert as well. Despite the fact that the taxes came due only upon Albert's death, “[t]hese taxes would not be due if Pearl were living, therefore they are due ‘as a result of’ [Pearl's] death.” Id.

Having thus convinced the court to order a refund of the additional estate tax and interest, the estate then sought an award of attorneys' fees and costs, arguing that it had “substantially prevailed” and that the government's position in the litigation had not been “substantially justified.” See 26 U.S.C. § 7430(c)(4). The government opposed the motion, arguing that the estate exceeded the $2 million net worth ceiling imposed on individuals eligible to recover litigation expenses and, in any event, that the government's position in the litigation had been “substantially justified.”

The court granted the estate's motion. The court was satisfied that the three sources of estate assets totalled less than $2 million as of the date of suit: by that time, the PWT had been distributed and had a value of $0; the AWT had a net value of between $902,369.91 and $955,295.00; and Albert's probate estate had an unspecified but concededly negligible value, certainly less than the more than $1 million it would take to put the estate over the $2 million limit. The court rejected the government's contention that the net worth of the estate should be calculated using the value of all assets in the estate at the time of Albert's death, \*467 including the PWT in particular, which had a value of approximately $1 million. Nov. 24, 1993 Mem. Op. and Order at 3-4. The court went on to conclude that the government's position in the suit had not been substantially justified: “Only by ignoring the unambiguous language of the PWT and through an absurd reading of the AWT and Albert's will was it even possible to understand the United States' argument.” Id. at 5. Having thus concluded that the estate qualified as a “prevailing party,” the court awarded the $17,147.00 in fees and $619.89 in costs requested. Id. at 6. From this award the government appeals.

## II.

The government renews each of the two objections it asserted below to the estate's request for fees and costs, maintaining that the estate did not satisfy the net worth requirement and that the government's position had been substantially justified. Because we conclude that the net worth of the estate, when properly calculated, exceeded the $2 million ceiling and thus rendered the estate ineligible to recover its fees and costs, we confine our analysis to that question alone; whether the government's position was “substantially justified” is a matter we need not reach.

We begin with the relevant statutory provisions. Section 7430 of the Internal Revenue Code provides:

In any ... court proceeding which is brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, the prevailing party may be awarded a judgment or a settlement for-

.....

(2) reasonable litigation costs incurred in connection with such court proceeding.

26 U.S.C. § 7430(a). The statute later defines “prevailing party” as follows:

(A) In general.-The term “prevailing party” means any party in any proceeding to which subsection (a) applies (other than the United States or any creditor of the taxpayer involved)-

(i) which establishes that the position of the United States was not substantially justified,

(ii) which-

(I) has substantially prevailed with respect to the amount in controversy, or

(II) has substantially prevailed with respect to the most significant issue or set of issues presented, and

(iii) which ... meets the requirements of section 2412(d)(2)(B) of ... title 28 (as so in effect).

26 U.S.C. § 7430(c)(4). By specifying that a party must meet the requirements of 28 U.S.C. § 2412(d)(2)(B), the statute incorporates the net worth requirements of the Equal Access to Justice Act. The EAJA provides:

“[P]arty” means (i) an individual whose net worth did not exceed $2,000,000 at the time the civil action was filed, or (ii) any owner of an unincorporated business, or any partnership, corporation, association, unit of local government, or organization, the net worth of which did not exceed $7,000,000 at the time the civil action was filed, and which had not more than 500 employees at the time the civil action was filed; except that an organization described in section 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(c)(3)) exempt from taxation under section 501(a) of such Code, or a cooperative association as defined in section 15(a) of the Agricultural Marketing Act (12 U.S.C. 1141j(a)), may be a party regardless of the net worth of such organization or cooperative association[.]

28 U.S.C. § 2412(d)(2)(B). See generally Wilfong v. United States, 991 F.2d 359, 364 (7th Cir.1993).

Notably, the EAJA does not list estates among the parties eligible to recover litigation costs. However, seeing no reason to treat estates differently from individuals, the Tax Court, the Court of Claims, and at least two district courts have concluded that estates should be permitted to recover their costs despite the statutory omission. \*468Estate of Hubberd v. C.I.R., 99 T.C. 335, 338-39, 1992 WL 224512 (1992); Papson v. United States, 82-1 USTC ¶ 13,466, 1982 WL 11261, at \*3 (Ct.Cl.1982) (per curiam); Boatmen's First Nat. Bank of Kansas City v. United States, 723 F.Supp. 163, 169 (W.D.Mo.1989); Hoffman v. Heckler, 656 F.Supp. 1136, 1137 (E.D.Pa.1987). See also Estate of Curry v. United States, 549 F.Supp. 47, 49 (S.D.Ind.1982), rev'd on other grounds, 706 F.2d 1424 (7th Cir.1983).FN1 Moreover, the Commissioner of Internal Revenue has proposed regulations pursuant to section 7430 that expressly include estates among the parties eligible to recover costs in administrative proceedings. Prop. Treas.Reg. § 301.7430-5(f)(1), 57 Fed.Reg. 61020, 61028 (Dec. 23, 1992). In view of these authorities, the government has conceded here that an estate can recover its litigation costs provided that it meets the other requirements of sections 7430 and 2412(d)(2)(B).

FN1. Papson and Hoffman construed the EAJA alone, as those cases were not tax-related and section 7430 was thus inapplicable. They are nonetheless relevant, given that section 7430 incorporates the EAJA's definition of the term “party.” Curry, although it involved tax litigation, pre-dated section 7430 and likewise relied on the EAJA alone.

[1] The parties also appear to agree that the pertinent net worth limitation is the $2 million limit applicable to individuals.FN2 One court has instead found the $7 million limit applicable, deeming the estate “an ‘organization,’ of assets and liabilities, for purposes of the statute.” Boatmen's, 723 F.Supp. at 169. Yet, most courts have either held or assumed that the estate should be treated on par with an individual, see Papson, 1982 WL 11261, at \*3; Estate of Curry, 549 F.Supp. at 49; Weiss v. C.I.R., 850 F.2d 111, 114 n. 3, 115 (2d Cir.1988); see also Prop. Treas.Reg. § 301.7430-5(f)(1), 57 Fed.Reg. 61020, 61028-logically so, in our view, given that an estate arises from the death of an individual and serves to dispose of that person's assets and liabilities.FN3

FN2. Below, the estate did suggest that the $7 million net worth limitation applicable to corporations and organizations should be applied to estates. See R. 31 at 3-4. The district court found it unnecessary to reach the issue, believing that the net worth of the estate did not in any event exceed the lower of the two limits. Nov. 24, 1993 Mem. Op. and Order at 3 n. 3. The estate has not renewed its argument on appeal; its brief is instead confined to the contention that the net worth of the estate, properly calculated, did not exceed $2 million. See Estate's Br. at 14-17. It has thus conceded that the $2 million limit governs.

FN3. A revenue measure approved by Congress in 1992 contained a provision specifying that estates would be eligible to recover fees subject to the $2 million net worth limitation. See Estate of Hubberd, 99 T.C. at 341 n. 3. However, that bill was vetoed by President Bush.

[2] The focus of the parties' dispute is on how the net worth of the estate is to be determined-a question of law that we examine de novo. See Curtis v. Shalala, 12 F.3d 97, 99 (7th Cir.1993). The EAJA indicates that the net worth of the individual (and thus, for our purposes, the estate) is to be measured as of the date the complaint was filed-here, in November of 1991. In the estate's view, this means that only assets remaining undistributed as of that date may be included in the calculation of net worth. The district court agreed. Accord Boatmen's, 723 F.Supp. at 169. In light of the unique nature and purpose of estates, however, we find ourselves persuaded by the government's contention that assets distributed in advance of suit cannot be disregarded in calculating the net worth of the estate.

The net worth limitations of the EAJA reflect one of the underlying purposes of that statute as well as section 7430-to make it economically feasible for private parties to challenge the unreasonable actions of a government with superior resources. See, e.g., State of Louisiana ex rel. Guste v. Lee, 853 F.2d 1219, 1223 & n. 22 (5th Cir.1988); Greater Detroit Resource Recovery Auth. v. Adamkus, 677 F.Supp. 521, 526 (E.D.Mich.1987). The EAJA's focus on net worth at the time a suit is filed is consistent with this notion. An individual, for example, might be worth many millions of dollars when her dispute with the government arises but suffer a reversal of fortunes that leaves her with only modest resources when the time comes to litigate. At that juncture, she is no less deterred from filing suit against the governmental behemoth than an individual who was never well off to begin with.

\*469 An estate is a somewhat different creature in this regard, however. It is not merely possible that an estate's assets will dwindle over time, but certain. After all, an estate is merely the sum total of a deceased person's property, destined for distribution to others in accordance with either the decedent's will or the state's inheritance laws. See Ind.Code § 29-1-1-3; Uniform Probate Code (U.L.A.) § 1-201(14) (1983 & Supp.1994); In re Estate of Francis, 327 N.C. 101, 394 S.E.2d 150, 155 (1990). As such, the estate has no ends of its own; its business is simply to marshal the deceased's assets, satisfy any debts, and distribute the remainder as dictated by the decedent and by law. See Jesse Dukeminier & Stanley M. Johanson, Wills, Trusts, and Estates, 30, 37-50 (4th ed. 1990). Consequently, in contrast to the vagarious ups and downs of individual and corporate wealth, the net worth of an estate can be expected to follow a relatively uniform progression toward zero as the estate is disbursed. Accordingly, any estate with a net worth in excess of the EAJA's $2 million ceiling will, sooner or later, drop below that limit.

It therefore would be somewhat arbitrary to evaluate an estate's entitlement to litigation costs based simply on what assets remain to be distributed as of the date the suit is filed. The practical ability of a given estate to shoulder the burden of litigation is best judged by the net value of the entire estate, including assets which have already been distributed by the date of suit. Estate administrators, after all, do not disburse assets willy nilly with no regard for bills that will come due in the future.FN4 Instead, a portion of the estate is routinely reserved to cover taxes, legal fees, administrative costs, and other expenses that necessarily will have to be paid before the estate can be closed; and distributions to the beneficiaries of the estate are adjusted accordingly. See Uniform Probate Code §§ 3-101, 3-805, 3-807, 3-902, 3-916; Ind.Code §§ 29-1-17-3, 29-1-17-4.FN5 Indeed, with that in mind, Pearl and Albert both included provisions in their trusts authorizing their successor co-trustees to withhold from distribution enough money to pay the taxes and other expenses their estates might be required to bear. App. 22a-23a, 39a; see also App. 14a. For this reason, it would be anomalous to treat a $5 million estate with $500,000 in undistributed assets remaining on the date of suit as the equivalent of a $500,000 estate with all assets undistributed as of that same date; the former clearly has a significantly greater ability to bear the expense of litigating with the government, and presumably the money remaining in the estate at the time of suit has in fact been set aside for the very purpose of handling that and other costs.

FN4. Nor do creditors turn a blind eye while estate assets are being distributed. We are confident, for example, that the estate's lawyers did not rest all of their hopes for compensation for their work in this case on the possibility of a fee award at the end of the litigation. More likely, they made some advance arrangements for their work on this case to be compensated from estate funds. See Uniform Probate Code § 3-720.

FN5. Indeed, should the estate's property be distributed too rapidly and the estate be left with taxes and other debts that exceed the assets on hand to satisfy them, the distributees may be called upon to make good on the outstanding obligations. Uniform Probate Code § 3-1004; 26 U.S.C. § 6324(a)(2). See, e.g., Berliant v. C.I.R., 729 F.2d 496 (7th Cir.), cert. denied sub nom. Kraft v. C.I.R., 469 U.S. 852, 105 S.Ct. 174, 83 L.Ed.2d 109 (1984); United States v. Geniviva, 16 F.3d 522 (3d Cir.1994).

Focusing merely on the value of assets undistributed on the date of suit would lead to other disparities as well. Consider two estates each with $3 million in net assets, and each pursuing identical tax disputes with the government: one is disbursed smoothly and on the date of suit retains only $100,000 in assets; the other is ensnared in an ugly will contest which leaves the entire corpus undistributed by the time litigation with the government commences. Relying on the remaining assets as the sole measure of the estate's eligibility for fees deprives the second estate of the opportunity to recover its litigation costs but bestows a windfall on the first estate despite the fact that both estates began with the same net worth.

Excluding distributed assets from the net worth calculation gives rise not only to these types of arbitrary distinctions between estates of comparable resources, but arguably gives estate administrators an incentive to \*470 manipulate the timing of distributions and litigation against the government in order to duck below the $2 million EAJA limit. Other litigants could theoretically do the same, of course, and yet it seems unlikely that a prosperous individual or corporation would shed assets simply to become eligible for an award of litigation expenses. But an estate is in the very business of disbursing assets, so it is quite plausible to think that it would suffer no detriment to orchestrate the timing of distributions in order to bring the remainder of the estate below the EAJA limit in advance of suit; and a clever personal representative might do just that.

Perhaps with these same considerations in mind, Congress included a provision in a 1992 revenue measure clarifying not only that estates with a net worth of less than $2 million would be eligible to recover fees, see n. 3, supra, but specifying that the net worth calculation should be made as of the date of the individual's death. Estate of Hubberd, supra, 99 T.C. at 341 n. 3. That bill was vetoed, however, leaving the statute in its present state. Given the EAJA's unqualified mandate to assess the net worth of individuals and corporations as of the date suit was filed, we do not believe ourselves free to read into the statute a different reference date for estates. Nonetheless, because the EAJA does not expressly identify estates as among the parties eligible to recover fees, we have some leeway in determining how, consistent with the spirit of section 7430 and the EAJA, the net worth of the estate on the date of suit is to be calculated. See generally American Agric. Movement, Inc. v. Board of Trade of City of Chicago, 977 F.2d 1147, 1155 (7th Cir.1992) (citing International Paper Co. v. Ouellette, 479 U.S. 481, 493, 107 S.Ct. 805, 812, 93 L.Ed.2d 883 (1987)). For the reasons we have already articulated, we conclude that the calculus must include all assets in the estate, including those already distributed. This holding follows naturally, we believe, from the notion that individuals and their estates should be treated as equals in terms of their eligibility to recover fees-the estate, after all, is no more and no less than the legacy of Albert Woll, whose own net worth became fixed upon his death, delimited by the sum total of all of his assets and liabilities. See Papson v. United States, supra, 1982 WL 11261, at \*3.FN6

FN6. As the government suggests, the approach we have adopted does permit fluctuations in the market value of estate assets that occur between the decedent's death and the date of suit to be recognized in the net worth calculation. An estate with substantial securities or real estate holdings, for example, that exceeded the $2 million limit as of the decedent's death might nonetheless become eligible to recover its expenses if a market crash were to deflate the net worth of the estate to a figure below $2 million by the time suit was filed.

[3] In opposing the estate's request for fees and costs before the district court, the government argued that when liabilities were deducted from the $2.9 million in total estate assets, the resulting net worth exceeded the $2 million ceiling. R. 29 at 10-11. In reply, although the estate disputed the government's contention that distributed assets should be included in the net worth calculation, it did not argue in the alternative that the government had in any event mistakenly calculated the net worth of the total estate, nor did it reserve the right to submit alternate calculations in the event the district court agreed that both distributed and undistributed assets must be included in the determination. See R. 31 at 5. Its brief on appeal likewise did not quarrel with the figures that the government used in calculating the net worth of the entire estate. Compare Government's Opening Br. at 44-45 n. 20 with Estate's Br. at 14-17. At oral argument, however, the estate's counsel seemed to suggest that even if all assets were included in the net worth determination, the estate still may not have exceeded the $2 million ceiling. Any such argument had long been waived, however. As the party seeking to recover its litigation costs, the estate bore the burden of establishing that it met the net worth limitations of the EAJA. See Wilfong v. United States, supra, 991 F.2d at 364 n. 7; Pate v. United States, 982 F.2d 457, 459 (10th Cir.1993); National Truck Equip. Ass'n v. National Highway Traffic Safety Admin., 972 F.2d 669, 671 (6th Cir.1992); Love v. Reilly, 924 F.2d 1492, 1494 (9th Cir.1991). In our view, that included the obligation to challenge the government's calculations if, indeed,\*471 the estate believed that the assets and liabilities had been tallied improperly. See Publishers Resource, Inc. v. Walker-Davis Publications, Inc., 762 F.2d 557, 561 (7th Cir.1985). Having omitted to make or reserve any such argument, the estate is bound by the government's figures.

## III.

Based upon the plain language of the EAJA, Judge Brooks understandably concluded that he should calculate the value of the estate at the time that the lawsuit was commenced and should not consider any assets that had been distributed prior to that time. We believe, however, that the statutory language must be construed in its proper context-i.e., in light of the underlying purpose of the EAJA-and that the unique nature of estates requires us to consider the value of the estate as a whole and not just those assets remaining at the time that the action was commenced. As the undisputed record reveals that the net worth of the estate exceeded $2 million when all assets were included, the estate was ineligible to recover its litigation expenses.

Reversed.

C.A.7 (Ind.),1994.
Estate of Woll by Woll v. U.S.
44 F.3d 464, 75 A.F.T.R.2d 95-354, 63 USLW 2428, 95-1 USTC P 60,187

United States District Court,
N.D. Ohio,
Eastern Division.

Robert R. Miller, et al., Plaintiffs,
v.
United States of America, Defendant.
No. 1:88-CV-4601.

May 22, 1996.

Estate which prevailed in federal estate tax refund suit moved for attorney fees and costs under Internal Revenue Code. The District Court, O'Malley, J., held that: (1) $2 million net worth limitation on prevailing party definition in Equal Access to Justice Act (EAJA) applies to estates, and (2) assets of revocable trust created by decedent and controlled by decedent during his lifetime were included when determining net worth of decedent's estate.

Denied.

\*643 Order

O'Malley, District Judge.

With this action, plaintiff Robert R. Miller sought a refund of over $5 million in federal estate taxes.FN1 The essential issue in the case was whether certain provisions contained in Miller's will and in a contemporaneous trust agreement disqualified a portion of the trust for the marital tax deduction. Following a bench trial, this Court determined that the trust assets in question did qualify for the marital tax deduction, and that plaintiff was entitled to a refund of estate taxes in the amount of $5,290,409.19, plus statutory interest. Opinion and Order at 20 (Dec. 12, 1995), modified in part, Order (Jan. 9, 1996).

FN1. Although the true plaintiff in this case is the estate of Robert R. Miller, the Court refers to plaintiff as Miller, himself, for ease of reference.

Plaintiff has moved for attorney fees and costs, pursuant to 26 U.S.C. § 7430 (docket no. 51). The Court finds that plaintiff is not entitled to attorney fees. Accordingly, the motion for fees is denied.

## I.

Plaintiff's initial claim for refund, filed June 24, 1998, sought $5,294,298.63, plus statutory interest. This Court ultimately found plaintiff was entitled to a refund of $5,290,409.19, plus statutory interest. The primary issues in the case were: (1) whether certain trust property was “qualified terminable interest property” (“QTIP”); and (2) whether the Ohio Apportionment statute applied to determine the apportionment of the estate taxes. After a trial to the bench, this Court agreed with plaintiff on both of these issues: the trust property at issue was QTIP property, and the Ohio Apportionment statute did apply. Order at 20-21 (Dec. 12, 1995). In sum, plaintiff substantially prevailed with respect to both the amount in controversy and the primary issues presented to the Court for resolution. Having substantially prevailed, plaintiff now seeks attorney fees in the amount of approximately $185,000, pursuant to 26 U.S.C. § 7430.

## II.

Section 7430 of the Internal Revenue Code, entitled “Awarding of costs and certain fees,” provides, in pertinent part:

(a) In general.-In any ... court proceeding which is brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, the prevailing party may be awarded a judgment or a settlement for-

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(2) reasonable litigation costs incurred in connection with such court proceeding.

26 U.S.C. § 7430(a). The statute goes on to define “prevailing party,” in pertinent part, as follows:

(c) Definitions.-For purposes of this section-

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(4) Prevailing Party.-

(A) In general.-The term “prevailing party” means any party in any proceeding to which subsection (a) applies (other than the United States or any creditor of the taxpayer involved)-

(i) which establishes that the position of the United States in the proceeding was not substantially justified;

(ii) which-

(I) has substantially prevailed with respect to the amount in controversy, or

\*644 (II) has substantially prevailed with respect to the most significant issue or set of issues presented, and

(iii) which ... meets the [net worth] requirements of section 2412(d)(2)(B) of title 28 (as so in effect).

26 U.S.C. § 7430(c)(4)(A).

[1] The pertinent net worth requirements in title 28 provide that a person does not qualify as a prevailing party unless he is “an individual whose net worth did not exceed $2,000,000 at the time the civil action was filed.” 28 U.S.C. § 2412(d)(2)(B)(i).FN2 By specifying that a “prevailing party” must meet the requirements of 28 U.S.C. § 2412(d)(2)(B), the statute incorporates the net worth requirements of the Equal Access to Justice Act. Estate of Woll v. United States, 44 F.3d 464, 467 (7th Cir.1994).

FN2. In addition to defining “prevailing parties” as limited to those individuals with net worths of less than $2 million, the statute also limits the definition to business-type entities with net worths of less than $7 million. 28 U.S.C. § 2412(d)(2)(B)(ii). Although one court has applied the $7 million limit to estates, deeming an estate to be an “organization,” Boatmen's First Nat. Bank of Kansas City v. United States, 723 F.Supp. 163, 169 (W.D.Mo.1989), the better view is clearly to apply the $2 million limit. Estate of Woll, 44 F.3d 464, 468 (7th Cir.1994).

The United States attacks plaintiff's qualifications as a “prevailing party” on two grounds. First, the United States argues plaintiff cannot “establish [ ] that the position of the United States in the proceeding was not substantially justified.” 26 U.S.C. § 7430(c)(4)(A)(i). Second, the United States argues plaintiff's net worth exceeded $2 million when he filed this action, so he cannot show he “meets the [net worth] requirements of section 2412(d)(2)(B) of title 28.” Id. at § 7430(c)(4)(A)(iii). FN3 The Court concludes the United States' second argument is well-taken: the net worth of the estate exceeds the $2 million ceiling, rendering the estate ineligible to recover its costs and fees. Given this conclusion, the Court does not reach the question of whether the government's position was “substantially justified,” nor whether the attorney fees requested are “reasonable.”

FN3. The United States does not argue, for good reason, that plaintiff did not substantially prevail with respect to the amount in controversy and/or the most significant issues presented.

## III.

As noted, by specifying that a “prevailing party” must meet the requirements of 28 U.S.C. § 2412(d)(2)(B), the statute incorporates the net worth requirements of the Equal Access to Justice Act (“EAJA”). The EAJA “provides limited exceptions to the general rule of sovereign immunity where recovery of costs against the United States is concerned. The exception should not be construed liberally.” National Truck Equip. v. Nat. Hwy. Safety Admin., 972 F.2d 669, 671 (6th Cir.1992). The fundamental premise of the EAJA is that “EAJA awards should be available where the burden of attorney's fees would have deterred the litigation challenging the government's actions, but not where no such deterrence exists.” Id. at 672 (quoting SEC v. Comserv Corp., 908 F.2d 1407, 1415-16 (8th Cir.1990)). Congress's statement of purpose behind the EAJA was that the legislation would “serve as an ‘equalizer’ for those litigants who could otherwise not afford costs of litigation against the federal government.” Id. at 673. “When [a litigant has] the economic power to pursue litigation against the government without being deterred by the costs, the congressional purposes of the EAJA are undermined by an award to [that litigant].” Id. at 674.

[2] Plaintiff argues that he was “an individual whose net worth did not exceed $2,000,000 at the time the civil action was filed,” and thus eligible for a fee award. The government disagrees with plaintiff's net worth calculation. The dispute boils down to how the net worth of the estate is calculated for the purpose of determining eligibility for an EAJA award of attorney fees.

The case of Estate of Woll v. United States, 44 F.3d 464 (7th Cir.1994), is highly instructive. The net worth of Woll's estate, at the time of Woll's death, exceeded $2 million. The estate eventually filed a lawsuit against the federal government for an estate tax refund, and prevailed. In seeking an \*645 EAJA award of attorney fees, the estate noted that, even though its net worth exceeded $2 million at the time of Woll's death, its net worth had diminished to about $1 million at the time it filed the refund action. Noting that EAJA requires an individual's net worth “not [to] exceed $2,000,000 at the time the civil action was filed,” the estate insisted it met the net worth requirement. 28 U.S.C. § 2412(d)(2)(B)(i). The district court agreed, further found that the government's position was “absurd” and thus not substantially justified, and awarded attorney fees and costs of about $17,800. Id. at 467.

The Seventh Circuit reversed, disagreeing with the district court's calculation of the estate's net worth. The court concluded that “assets distributed in advance of suit cannot be disregarded in calculating the net worth of the estate.” Id. at 468. The court noted that the underlying purpose of the EAJA was “to make it economically feasible for private parties to challenge the unreasonable actions of a government with superior resources,” id., and concluded that “[t]he practical ability of a given estate to shoulder the burden of litigation is best judged by the net value of the entire estate, including assets which have already been distributed by the date of suit,” id. at 469. In the case of Woll, these assets included assets Woll had placed in a revocable trust during his lifetime. Id. at 466.

In this case, Robert Miller had a gross estate of over $13 million, including about $10.6 million he had placed in a revocable trust during his lifetime. Under the trust agreement, possession and enjoyment of the trust assets were reserved exclusively to Mr. Miller until after death; he retained complete control over the income and corpus. Ultimately, this $10.6 million in trust became an allowable deduction as a bequest to Miller's spouse, reducing the taxable estate. After subtracting from the total gross estate this $10.6 million, and also funeral expenses, debts, and estate tax, the net worth of Miller's estate was reduced to about $1.4 million.

[3] Pursuant to the analysis in Estate of Woll, however, the net worth of plaintiff in this case for the purpose of determining eligibility for an award of attorney fees under EAJA exceeds $2 million. Including the assets Miller had placed in a revocable trust during his lifetime, Miller had a net worth of at least $12 million at the time of his death, for all practical purposes. It is this amount that is properly examined in assessing the propriety of a motion for attorney fees under EAJA. Plaintiff correctly argues that the government accepted a valuation of the net worth of the estate, at the date of death, of about $1.4 million, as reflected in plaintiff's estate tax return. This amount, however, is not the true measure of plaintiff's “economic power to pursue litigation against the government without being deterred by the costs.” National Truck Equip., 972 F.2d at 674. The better measure of whether the court should make an exception to the general rule of sovereign immunity for recovery of costs against the United States is the practical net worth of the decedent, as measured by those assets over which he retained complete control at death, minus applicable liabilities-in this case, at least $12 million. It is this amount that accurately appraises “[t]he practical ability of a given estate to shoulder the burden of litigation.” Estate of Woll, 44 F.3d at 469.

[4] The Court does not mean, in this opinion, to set out a hard and fast rule as to how net worth must be measured for purposes of determining eligibility for an award of attorney fees under 26 U.S.C. § 7430 or 28 U.S.C. § 2412(d)(2)(B). The Court does note, however, that 26 U.S.C. § 7430 states “the prevailing party may be awarded a judgment or a settlement for ... reasonable litigation costs.” See In Re Rasbury, 24 F.3d 159, 166 (11th Cir.1994) (noting that court has discretion on whether to award attorney fees). The Court's discretion in deciding whether to make such an award must be made against the background principles that: (1) exceptions to sovereign immunity must be construed narrowly; and (2) the congressional purposes of the EAJA are undermined by an award to a litigant which, when measured realistically, has the economic power to pursue litigation against the government without being deterred by the costs. The Court finds that, on the facts of this case, an award of attorney fees to plaintiff is \*646 inappropriate because, measured realistically, plaintiff does not meet the net worth requirements set out in 28 U.S.C. § 2412(d)(2)(B)(i). Accordingly, the motion for attorney fees is denied.

It is so ordered.

N.D.Ohio,1996.
Miller v. U.S.
926 F.Supp. 642, 79 A.F.T.R.2d 97-1479, 96-2 USTC P 60,236

1. The Internal Revenue Code is located in Title 26 of the United States Code. All references are to the Internal Revenue Code of 1986, as amended, unless otherwise noted. [↑](#footnote-ref-1)
2. See 26 U.S.C. § 7430(c)(4)(D) and 28 U.S.C. § 2412(d)(2)(B); see also Stieha v. Comm'r, 89 T.C. 784, 786 (1987) (stating that net worth is tested on the date original petition is filed); Robert J. Stuart, Taxpayer Procedures and Remedies in Tax Controversies, 61 TAX LAW. 941, 945 (2008) (“Generally speaking, a taxpayer's net worth is tested on the date the litigation commences (for example, the petition or complaint date) for purposes of ‘shifting the burden of proof.’”). [↑](#footnote-ref-2)
3. Southgate, 651 F. Supp. 2d at 652. [↑](#footnote-ref-3)
4. Id. [↑](#footnote-ref-4)
5. Id. [↑](#footnote-ref-5)
6. Id. [↑](#footnote-ref-6)
7. Id. [↑](#footnote-ref-7)
8. Estate of Woll v. United States, 44 F.3d 464 (7th Cir. 1994); Miller v. United States, 926 F. Supp. 642 (N.D. OH 1996). Both cases are copied from Westlaw and pasted below for the reader’s reference. [↑](#footnote-ref-8)
9. Estate of Woll, 44 F.3d at 464. [↑](#footnote-ref-9)
10. Id. [↑](#footnote-ref-10)
11. Miller, 926 F. Supp. at 642. [↑](#footnote-ref-11)
12. Taxpayer Relief Act of 1997, Pub. L. No. 05-34, § 1453(a) (effective for proceedings commenced after Aug. 5, 1997). [↑](#footnote-ref-12)
13. See definition of person for purposes of 28 U.S.C. § 2412(d)(1)(B) at 28 U.S.C. § 2412(d)(2)(B). [↑](#footnote-ref-13)
14. Southgate, 651 F. Supp. 2d at 652. [↑](#footnote-ref-14)
15. Id. [↑](#footnote-ref-15)
16. Id. [↑](#footnote-ref-16)