UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Docket Number: 12-70259

JEFFREY K. and KRISTINE K. BERGMANN,

Petitioners and Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent and Appellee.

Appeal from the United States Tax Court
Case No. 20894-05
Judge Diane L. Kroupa

RENEWED OPENING BRIEF OF APPELLANTS JEFFREY K. and KRISTINE K. BERGMANN

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CORPORATE DISCLOSURE STATEMENT

This statement is made pursuant to Federal Rule of Appellate Procedure rule 26.1. Neither of the Respondents and Appellants are corporate entities and have no parent corporation, subsidiaries or affiliates that have issued shares to the public.

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I. Basis for the Tax Court's Subject-Matter Jurisdiction.

Respondent and Appellee Commissioner of Internal Revenue ("IRS") issued a notice of tax deficiency to Petitioners and Appellants Jeffrey K. and Kristine K. Bergmann dated August 10, 2005. (SER 88, i.e., the *Supplemental Excerpts of Record* filed by the IRS, which has been adopted by Petitioners and approved by the Court (Doc 36).) Petitioners timely filed a petition in the United States Tax Court challenging the IRS notice of deficiency on November 7, 2005. (SER 95.)

The United States Tax Court had subject matter jurisdiction to hear the petition pursuant to 26 U.S.C. § 7442.

II. Basis for the Court of Appeals' Jurisdiction.

Appellants are residents in this circuit (SER 14) and the Tax Court trial was conducted in this circuit in San Francisco, California. (SER 33.)

This Court has jurisdiction to hear this appeal of the Tax Court decision pursuant to 26 U.S.C. § 7482(a)(1).

III. Filing Dates Establishing the Timeliness of the Appeal.

The Tax Court's decision was entered on October 27, 2011. (SER 32.) This appeal was timely filed on January 25, 2012. (SER 75.)

IV. Assertion That the Appeal Is from a Final Order or Judgment That Disposes of All Parties' Claims.

This appeal is from a final Decision of the Tax Court that disposes of all parties' claims. (SER 30.)

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Did the Tax Court error in its conclusion of law that Appellants owe an accuracy-related penalty of $41,196.00 pursuant to 26 U.S.C. § 6662(a) for tax year 2001 on the grounds that Appellants had not filed a valid qualified amended return ("QAR") under 26 C.F.R. § 1.6664-2(c)?

Appellants contend that the Tax Court erroneously applied a later enacted version of 26 C.F.R. § 1. 6664-2(c)(3)(ii) to decide that the amended return did not qualify as a QAR. Appellants contend that the version of 26 C.F.R. § 1.6664-2(c)(3)(ii) in effect at the time of the filing of the amended return, which the Tax Court should have applied, permitted the amended return to be treated as a valid QAR.

The issue was presented to the Tax Court in Appellants' Post-Trial Brief (SER 55), at trial, was addressed in the Tax Court's opinion published at 137 T.C. 136 (SER 12), and was the subject of a post-decision motion to vacate (SER 63), which was denied by the Tax Court. (SER 31.)

The standard of review for conclusions of law reached by the Tax Court is *de novo*. (*Boyd Gaming Corp. v. C.I.R.*, 177 F.3d 1096, 1098 (9th Cir. 1999).

STATEMENT OF THE CASE

The Tax Court was asked to decide whether the IRS must impose a promoter penalty under 26 U.S.C. § 6700 (relating to abusive tax shelters) to terminate the time to file a QAR under 26 C.F.R. § 1.6664-2(c)(3)(ii). The Tax Court found that, even though the IRS never established that KPMG was liable for a promoter penalty under section 6700, the commencement of an investigation of KPMG for promoter penalties under section 6700 ended the time period in which Appellants could file a valid QAR.

The Tax Court found that the Appellants' QAR was invalid and upheld the IRS' assessment of an accuracy related penalty under 26 U.S.C. § 6662(a).

For the purposes of this appeal, Appellants concede that the version of 26 C.F.R. § 1.6664-2(c)(3)(ii) in effect at the time the Tax Court's decision was reached supports the Tax Court's decision.

The version of 26 C.F.R. § 1.6664-2(c)(3)(ii) in effect at the time of the filing of the amended return, however, required that the IRS establish that: 1) KPMG is described in 26 U.S.C. § 6700(a); and 2) and the contact with KPMG by the IRS must be concerning an examination of an activity described in 26 U.S.C. § 6700(a) with respect to which Appellants claimed a tax benefit. The IRS failed to do so.

This appeal asks the Court to determine which version of 26 C.F.R. § 1.6664-2(c)(3)(ii) applies to Appellants' amended return and, based on that decision, whether the amended return was a QAR.

STATEMENT OF FACTS

As set forth in the Tax Court's opinion reported at 137 T.C. 136 (SER 12), the Tax Court found that while Appellant Jeffrey Bergmann was employed at KPMG LLP in 2000 and 2001 (SER 14), he entered into a foreign exchange option transaction that "was the same as or substantially similar to a transaction described in [IRS] Notice 2000–44, 2000–2 C.B. 255 (transactions generating losses by artificially inflating basis)." (SER 15.) Appellants reported those transactions on their tax returns for tax years 2000 and 2001. (SER 17.)

The Tax Court further found that, in October 2001, the IRS notified KPMG that it was considering imposing penalties on KPMG for promoting abusive tax shelters. (SER 16.) In February 2002, the IRS notified KPMG that it was conducting an examination to determine KPMG's liability for organizing various tax shelters from 1994 to the present. (SER 16.) On March 19, 2002, the IRS served two summonses on KPMG relating to its tax shelter activities. (SER 17.) Those summonses stated they concern an examination of KPMG for liability under 26 U.S.C. § 6700 regarding a promoter penalty. (SER 17.) One of the summonses defined the transactions to which it applied as transactions that were the same as or substantially similar to a transaction described in Notice 2000–44. (SER 17.)

Appellants filed an amended Federal tax return for tax year 2001 in March 2004. (SER 17.) Petitioners removed the losses attributable to the 2000 and 2001

transactions on the amended return and reported and paid the additional tax. (SER 17-18.)

The IRS audited the amended return and, amongst other items not relevant on appeal, imposed an accuracy related penalty under 26 U.S.C. § 6662(a). (SER 18.) Appellants timely filed a challenge to that assessment in the Tax Court. (SER 18.)

The Tax Court decided that Appellants' amended return was not a QAR since an investigation of KPMG by the IRS pursuant to 26 U.S.C. § 6700 had already commenced (SER 20), even though no determination was ever made that KPMG violated section 6700 and no promoter penalties were ever assessed against KPMG. (SER 24-25.)

SUMMARY OF THE ARGUMENT

The version of 26 C.F.R. § 1.6664-2(c)(3)(ii) in effect at the time of the filing of Appellants' amended return required that, in order to conclude the time period in which Appellants could permissibly file a qualified amended return, the Tax Court was required to find that: 1) KPMG is described in 26 U.S.C. § 6700(a); and 2) and the contact with KPMG by the IRS must be concerning an examination of an activity described in 26 U.S.C. § 6700(a) with respect to which Appellants claimed a tax benefit.

Appellants contend they timely filed their amended return to qualify as a QAR, the determination that their amended return was not a valid QAR under 26 C.F.R. § 1.6664-2(c)(3)(ii) was erroneously based on a later enacted version of the regulation, and that the decision that Appellants are liable for an accuracy related penalty under 26 U.S.C. § 6662(a) is incorrect as a matter of law.

ARGUMENT

The opinion of the Tax Court concluded that the amended filed by Petitioners in March 2004 for tax year 2001 was not a qualified amended return under 26 C.F.R. § 1.6664-2(c). As a result, the Tax Court upheld the accuracy related penalty imposed on Appellants by the IRS under 26 U.S.C. § 6662(a).

The Tax Court reached this decision in error by failing to apply the version of 26 C.F.R. § 1.6664-2(c)(3)(ii) that was in effect at the time the amended return was filed.

The Tax Court opinion discusses the provision in 26 C.F.R. § 1.6664-2(c) (which the opinion labels as the "promoter provision"), but the opinion does not quote the regulation. The Tax Court states (SER 19):

> Under the promoter provision, the period to file a QAR terminates when the IRS first contacts a person concerning liability under § 6700 (a promoter investigation) for an activity with respect to which the taxpayer claimed a tax benefit.

This description tracks the language of the current regulation, which is:

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

This provision was incorporated into the regulation in March 2005 by Treasury Decision 9186. The regulation was made with limited retroactive effect;

the revised regulation was stated in T.D. 9186 to be effective March 2, 2005 and was applicable to amended returns filed on or after April 30, 2004 (based on the issue date of Notice 2004-38). April 30, 2004 is *after* Appellants filed their amended return on March 15, 2004.

In contrast, the regulation that is applicable to Appellants' amended return provides:

> The time any person described in § 6700(a) (relating to the penalty for promoting abusive tax shelters) is first contacted by the Internal Revenue Service concerning an examination of an activity described in § 6700(a) with respect to which the taxpayer claimed any benefit on the return directly or indirectly through the entity, plan or arrangement described in § 6700(a)(1)(A);

As can be seen from comparing the language of the regulation in force when Appellants filed their amended tax return to the subsequently amended regulation, the description in the Tax Court's opinion (SER 19) follows the amended (non applicable) language rather than the earlier applicable regulation language.

The language of the earlier applicable regulation requires a "person described in § 6700(a) is first contacted by the Internal Revenue Service" and that the contact must be "concerning an examination of an activity described in § 6700(a)."

The new regulation, in contrast, does not include the "described in § 6700(a)" language for the person being contacted or the activity being

considered. As relevant to Appellants' case, in order for the QAR to be invalid, KPMG must be "described in § 6700(a)" and the contact with KPMG must be concerning "an examination of an activity described in § 6700(a)" with respect to which Appellants claimed a tax benefit.

Regardless of whether paying the penalty imposed by § 6700 is necessary for a person to be "described in § 6700(a)," certainly the requirements of both §§ 6700(a)(1) and (a)(2) have to be satisfied to be "described in § 6700(a)." Section 6700(a) covers "any person who" does the things in (a)(1) "and" the things in (a)(2).

The Tax Court's opinion, however, only addresses whether KPMG was contacted concerning the penalty under § 6700 for an activity (whether or not described in § 6700(a)) to which Appellants claimed a tax benefit. The opinion does not consider whether KPMG satisfied the requirements of § 6700(a)(2). The opinion applies the new regulation–not the applicable earlier regulation. KPMG is not described in § 6700(a) if it merely satisfies the requirement of § 6700(a)(1) but not § 6700(a)(2). 26 C.F.R. § 1.6664-2(c)(3)(ii) did not say only a "person described in § 6700(a)(1)." Section 6700(a)(1) is joined to § 6700(a)(2) with the conjunction "and' so *both* provisions must be satisfied. They were not.

The Internal Revenue Service and the Treasury Department know how to limit a reference, as shown by the reference at the end of the sentence to "§ 6700(a)(1)(A)" in both the current regulation and the prior regulation.

Moreover, the applicable regulation requires that the contact of KPMG must be concerning "an examination of an activity described in § 6700(a)." Thus, it is necessary to determine as well that Appellants' transactions are described in §§ 6700(a)(1) and (a)(2). The regulation does not say that it is concerning any activity, or even an activity only described in § 6700(a)(1).

The Tax Court's opinion does not determine that in fact KPMG is described in § 6700(a) because the opinion does not consider whether KPMG is described in § 6700(a)(2). Similarly, the opinion does not determine that Appellants' transactions are described in § 6700(a) because, again, the opinion did not determine that § 6700(a)(2) is satisfied for either of Appellants' transactions. Consequently, by erroneously applying the current version of the regulation, which does not have the "described in § 6700(a)" requirements, rather than the requirements of the earlier regulation that was applicable to Appellants' amended return, the Tax Court did not determine that all of the requirements of the applicable regulation had been satisfied.

KPMG is not described in § 6700(a)(2), nor was there a finding that either of Appellants' transactions constituted an activity that is described in § 6700(a)(2).

Moreover, in making the determination, Appellee has the burden of production pursuant to 26 U.S.C. § 7491(c).

Consequently, because the Tax Court erred in applying the current regulation, it erred in find that Appellants QAR was not valid.

CONCLUSION

In light of the foregoing error of law, the Court should reverse the Tax Court's Decision, find that the Tax Court erroneously applied the later enacted version of 26 C.F.R. § 1.6664-2(c)(3)(ii), find that Appellants' amended return was a valid QAR under 26 C.F.R. § 1.6664-2(c), and reverse the imposition of the accuracy related penalty under 26 U.S.C. § 6662(a).

Respectfully Submitted.

DATED: October 19, 2012

s/ Bradley A. Patterson
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NINTH CIRCUIT LOCAL RULE 28-2.6 STATEMENT

Counsel for Appellants in this case also represents Petitioners in the Tax Court case entitled *Dale A. & Jane G. Affonso v. Commissioner of Internal Revenue*, docket number 5242-10. That case, which is presently stayed pending a decision in this appeal, presents a similar issue as that presented in this appeal.

DATED: October 19, 2012

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CERTIFICATE OF COMPLIANCE WITH

TYPE-VOLUME LIMITATION, TYPEFACE REQUIREMENTS,

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I certify that this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 2,580 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

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DATED: October 19, 2012

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