No. 12-70259

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JEFFREY K. BERGMANN and KRISTINE K. BERGMANN,

Petitioners-Appellants

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

ON APPEAL FROM THE DECISION
OF THE UNITED STATES TAX COURT

ANSWERING BRIEF FOR THE COMMISSIONER

KATHRYN KENEALLY
Assistant Attorney General

RICHARD FARBER (202) 514-2959
ANTHONY T. SHEEHAN (202) 514-4339
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

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GLOSSARY

Commissioner:	Commissioner of Internal Revenue (Respondent-Appellee)
CR:	Court Record (documents in the record on appeal but not in the Supplemental Excerpts of Record) (references are to document number and page therein)
Ex.	Exhibit (admitted exhibits in record on appeal but not in the Supplemental Excerpts of Record)
I.R.C.:	Internal Revenue Code of 1986 (26 U.S.C.)
QAR:	Qualified Amended Return
SER:	Supplemental Excerpts of Record (references are to page number)
Tax Court:	The United States Tax Court
Taxpayers:	Jeffrey K. and Kristine K Bergmann (Petitioners-Appellants) (because Jeffrey Bergmann is responsible for the transactions at issue, references to "taxpayer" are to him)
TEFRA:	Tax Equity and Fiscal Responsibility Act of 1982 (I.R.C. §§ 6221-6234)
Treas. Reg.:	Treasury Regulations (26 C.F.R.)

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STATEMENT OF JURISDICTION

On August 10, 2005, the Commissioner of Internal Revenue sent a notice of deficiency under I.R.C. § 6212(a) to Jeffrey K. and Kristine K. Bergmann determining an addition to their 2001 income taxes for the I.R.C. § 6662 accuracy-related penalty. (SER 88.) On November 7, 2005, taxpayers filed a timely petition with the United States Tax Court within 90 days after the mailing of the notice of deficiency. (SER 95.)

I.R.C. § 6213(a). The Tax Court had jurisdiction under I.R.C. §§ 6213(a), 6214, and 7442.[1]

On October 27, 2011, the Tax Court entered a final decision disposing of all of the parties' claims. (SER 30.) On January 24, 2012, taxpayers filed a timely notice of appeal within 90 days after the entry of the Tax Court's decision. (SER 75.) I.R.C. § 7483. This Court has jurisdiction under I.R.C. § 7482(a)(1).

STATEMENT OF THE ISSUE

Whether the Tax Court correctly determined that taxpayers did not file a qualified amended return for 2001, and that, therefore, they were liable for the accuracy-related penalty imposed by the Commissioner under I.R.C. § 6662 because of their underpayment of tax, which was the result of their participation in a tax shelter.

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[1] As the Tax Court noted (SER 18 n.4), although the instant litigation arose out of taxpayers' participation in a tax-shelter partnership, the partnership audit and litigation procedures of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) (I.R.C. §§ 6221-6234) are inapplicable here either because taxpayers came within the small-partnership exception of I.R.C. § 6231 (a)(1)(B)(i), or because the Commissioner determined (under I.R.C. § 6231(g) and upon examination of the partnership return) that the TEFRA provisions would not apply.

STATEMENT OF THE CASE

Taxpayers petitioned the Tax Court for a redetermination of an I.R.C. § 6662 accuracy-related penalty imposed by the Commissioner for tax year 2001. (SER 88, 95.) At issue on appeal is whether taxpayers' amended tax return for 2001 was a qualified amended return (QAR), which would have the legal effect of eliminating the tax underpayment on which the penalty was computed. Taxpayers stipulated that, if their amended return was not a QAR, they were liable for a 20% accuracy-related penalty for 2001 in the amount of $41,196.[2] (SER 13, 50.)

Taxpayers moved for summary judgment on the QAR issue, but the Tax Court (Judge Diane L. Kroupa) issued a memorandum opinion (unofficially published at T.C. Memo. 2009-289, 2009 WL 4861128) denying taxpayers' motion because of the existence of genuine issues of material fact. (SER 1-11.) After a trial, the Tax Court issued an

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[2] The Commissioner conceded in the Tax Court that taxpayers were not liable for a deficiency for 2001, a deficiency for 2002, or a penalty for 2002. (SER 13, 50, 88.) The Tax Court rejected the Commissioner's contention that the 2001 accuracy-related penalty should be at the 40% rate for a gross valuation misstatement (*see* I.R.C. § 6662(h)). (SER 26-29.) The Commissioner did not appeal from that determination.

opinion (published at 137 T.C. 136) holding that taxpayers' amended return was not a QAR. (SER 12-29.) The court entered a decision that taxpayers were liable for the penalty in the stipulated amount (SER 30), and it denied taxpayers' motion to vacate (SER 31). This appeal followed. (SER 75.)

STATEMENT OF THE FACTS

A. The SOS shelter and taxpayers' 2001 amended tax return

At issue is whether taxpayers filed a qualified amended return (QAR) for 2001 so as to be able to avoid liability for a 20% accuracy-related penalty under I.R.C. § 6662(a) for their participation in the Short Option Strategy (SOS) tax shelter developed and marketed by the accounting firm KPMG. On appeal, taxpayers dispute only the correct interpretation of what the Tax Court called the "promoter provision" of the QAR timing regulation—Treas. Reg. § 1.6664-2(c)(3)(ii) (currently Treas. Reg. § 1.6664-2(c)(3)(i)(B)). The facts relevant to this narrow issue are set forth below.

In 2000 and 2001, taxpayer was a tax partner in the Stratecon group of the KPMG accounting firm. (SER 14, 33-34.) Stratecon designed, promoted, and implemented aggressive tax-planning

strategies for high-net-worth individuals. (SER 14, 33-34.) Taxpayer and fellow Stratecon partner David Greenberg worked on a tax-planning strategy known as the Short Option Strategy (SOS), in which taxpayers sought to generate artificial tax losses using offsetting foreign-exchange option contracts and a partnership or limited liability company set up to hold the contracts. (SER 14-15, 34-35.)

Starting around 2000, Greenberg began implementing SOS and substantially similar transactions (described by the Tax Court as "SOS-like" transactions) for KPMG clients and partners. (SER 15-16, 35-37.) Taxpayers engaged in an SOS-like transaction in 2000 ("the 2000 transaction"), and a second SOS-like transaction in 2001 ("the 2001 transaction"). (SER 16, 37-45.) The Tax Court found that taxpayers' 2000 transaction 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).[3] (SER 16, 24-26.)

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[3] Inasmuch as that finding was legally sufficient to disqualify taxpayers' amended return as a QAR, the Tax Court did not need to make a similar finding regarding the 2001 transaction. (*See* SER 24.) Treasury Regulation § 1.6664-2(c)(3)(ii) requires that a QAR be filed

(continued…)

In October 2001 and February 2002, the Commissioner notified KPMG that he was examining KPMG's tax-shelter activities. (SER 16, 45-46.) On March 19, 2002, the Commissioner served two summonses on KPMG, requesting documents, records, and testimony relating to its tax-shelter activities. (SER 76-78; *see also* SER 17, 46-48.) The summonses stated they concern an examination of KPMG for liability under I.R.C. § 6700 ("Promoting abusive tax shelters, etc."). (SER 76, 78.) One of the summonses (Exhibit 23-R) stated that it applied to transactions that are the same as, or substantially similar to, transactions described in Notice 2000-44, *supra* (the "Notice 2000-44 summons"). (SER 77.)

On August 19, 2002, taxpayers timely filed (on extension) an income tax return for 2001. (SER 17, 48, 79-84.) They claimed that they had incurred in 2001 both a $346,609 ordinary loss arising out of

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before the IRS's first contact of "any person" described in I.R.C. § 6700(a) concerning an examination of "an activity" described in I.R.C. § 6700(a). Thus, if a taxpayer claimed the benefit of multiple tax shelters, the first contact of one of the promoters with respect to one of the shelters terminates the time for filing a QAR altogether.

the 2000 transaction and a $295,500 long-term capital loss arising out of the 2001 transaction. (SER 17, 48, 81-84.)

On March 15, 2004, taxpayers filed an amended tax return for 2001. (SER 17-18, 48-49, 85-87.) Taxpayers removed the losses that they had claimed on their original 2001 return arising out of the 2000 and the 2001 transactions, and they reported and paid $205,979 in additional income tax. (SER 17-18, 48-49, 85-87.)

B. The Tax Court proceedings

Taxpayers stipulated that, if their amended return was not a QAR, they were liable for a 20% accuracy-related penalty for 2001 in the amount of $41,196. (SER 13, 50.) Section 6662(a) and (b) of the Code impose an accuracy-related penalty in an amount equal to 20% of the portion of a taxpayer's underpayment attributable, *inter alia*, to negligence, substantial understatement of tax, or a substantial valuation misstatement. The Tax Court noted that a taxpayer "can avoid having an underpayment," and, thus, avoid "the imposition of an accuracy-related penalty by filing a QAR." (SER 19.) The court explained that a QAR is "an amended return that is filed before certain terminating events," and that a QAR allows a taxpayer to avoid a

penalty because the "QAR treats additional tax reported on an amended return as tax reported on the original return." (SER 19.) In other words, a QAR reduces or eliminates the underpayment to which the accuracy-related penalty otherwise would be applied.

The Commissioner invoked the QAR terminating event found in what the Tax Court called the "promoter provision," *viz.*, Treas. Reg. § 1.6664-2(c)(3)(ii). (SER 19.) The Commissioner maintained that the promoter provision terminates the time for filing a QAR as of the date that the IRS first contacts a tax-shelter promoter regarding an examination of a particular shelter to determine whether the IRS will penalize the promoter for that shelter under I.R.C. § 6700. (*See* SER 19.) Taxpayers contended that the Commissioner had to prove that the promoter was liable for the I.R.C. § 6700 penalty for the first contact to be a terminating event for a QAR. (SER 19-20.)

The Tax Court framed the issue (which it described as an issue of first impression) as "whether the Commissioner must impose a promoter penalty under [I.R.C. § 6700] (relating to abusive tax shelters) to terminate the time to file a QAR under [Treas. Reg.

§ 1.6664-2(c)(3)(ii)] (the promoter provision)." (SER 18-19.) It answered that question as follows (SER 19-20):

> Under the promoter provision, the period to file a QAR terminates when the IRS first contacts a person concerning liability under section 6700 (a promoter investigation) for an activity with respect to which the taxpayer claimed a tax benefit. Sec. 1.6664-2(c)(3)(ii), Income Tax Regs. [Taxpayers] argue that [the Commissioner] must establish that the person contacted about a promoter investigation is in fact liable for a promoter penalty under section 6700 (the penalty requirement). We do not find any penalty requirement in the promoter provision.[5] [The Commissioner] need not have found KPMG liable for the promoter penalty under section 6700. We therefore reject [taxpayers'] argument.
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> [5] A U.S. District Court also rejected the argument that the promoter provision includes the penalty requirement. See *Sala v. United States*, 100 AFTR 2d 2007-5097, 2007-2 USTC par. 50,567 (D. Colo. 2007). We note that this decision is not binding on us. See *infra* pp. 13-14.

The Tax Court then evaluated the evidence regarding when the IRS first contacted KPMG about a promoter investigation concerning the 2000 and 2001 shelter transactions reported on taxpayers' 2001 return, but retracted on their amended return. (SER 20-26.) Taxpayers filed their amended return on March 15, 2004, making that "the dispositive date by which [the Commissioner] had to contact KPMG concerning a promoter investigation." (SER 20.) The Tax Court found,

however, that the March 19, 2002 summonses to KPMG were a terminating event under the promoter provision, inasmuch as: (1) the summonses "explicitly stated that they concerned the liability of KPMG under section 6700" (SER 20-21); (2) Greenberg was acting as KPMG's agent in organizing and coordinating taxpayers' 2000 and 2001 transactions, making those transactions attributable to KPMG (SER 21-24); and (3) the Notice 2004-44 summons covered taxpayers' 2000 transaction (SER 24-26).

The Tax Court "ultimately conclude[d] that the amended return [taxpayers] filed was not a QAR since it was filed after [the Commissioner] issued KPMG the Notice 2002-44 summons." (SER 26.) Consequently, the court held that the additional tax reported on the amended return was not deemed to have been reported on taxpayers' original return, and that, therefore, taxpayers had an underpayment of tax for 2001 to which the accuracy-related penalty could be applied. (SER 26.)

After the Tax Court entered its decision (SER 30), taxpayers filed a motion to vacate in which they argued that the Tax Court had erroneously applied a later, amended version of the promoter provision

instead of the version that was in effect when taxpayers filed their amended return (SER 63-68). After considering the Commissioner's objection (SER 69-74), the Tax Court denied taxpayers' motion (SER 31). This appeal followed. (SER 75.)

SUMMARY OF ARGUMENT

1. Section 6662 of the Internal Revenue Code imposes an accuracy-related penalty equal to 20% of the portion of any underpayment of tax attributable to negligence or other listed errors. An underpayment is the amount by which a taxpayer's actual tax exceeds the tax reported by the taxpayer on his return. If a taxpayer files a qualified amended return (QAR) (*i.e.*, an amended return filed before the earliest "terminating event" listed in Treas. Reg. § 1.6664-2(c)) the tax shown on his original return will include the additional tax reported on the QAR, reducing the underpayment.

The terminating event at issue is what the Tax Court called the "promoter provision," *viz.*, Treas. Reg. § 1.6664-2(c)(3)(ii) (currently Treas. Reg. § 1.6664-2(c)(3)(i)(B)). The promoter provision terminates the time for filing a QAR when the IRS first contacts a tax-shelter promoter concerning an examination of an activity for which the

promoter could be penalized under I.R.C. § 6700, and with respect to which the taxpayer claimed any tax benefit.

2. There is no basis for taxpayers' argument that the Tax Court erroneously applied a later, inapplicable version of the regulation. In its opinion, the court cited the applicable regulation and a district court opinion that had identically construed that version of the regulation.

3. Taxpayers erroneously contend that the phrases "person described in section 6700(a)" and "activity described in section 6700(a)" in the applicable Treas. Reg. § 1.6664-2(c)(3)(ii) mean that the IRS must prove that the third-party shelter promoter and its activities satisfied the requirements to be penalized under I.R.C. § 6700, for an IRS contact of the promoter to become a terminating event for a QAR.

Treasury Regulation § 1.6664-2(c)(3) defines a QAR primarily in terms of its *timing*. To be a QAR, the amended return must be filed "before the earliest" of a list of terminating events, each of which is triggered by the time some person or entity "is first contacted by the Internal Revenue Service" about an examination. In this context, it makes little sense to read into the promoter provision the added requirement of penalty conduct by a third party that has nothing to do

with the timing of the first IRS contact of that third party. Instead, the "described in" phrases are best read as characterizing, for informational purposes, the type of person and the type of examination that trigger the terminating event.

Any remaining ambiguity regarding Treas. Reg. § 1.6664-2(c)(3)(ii) is resolved by the principle that an agency's interpretation of its own regulations is controlling, unless plainly erroneous or inconsistent with the regulatory text. In promulgating the current version of the promoter provision (Treas. Reg. § 1.6664-2(c)(3)(i)(B)), the IRS explained that the amended regulation merely clarifies the original regulation that the terminating event is the first contact of a tax-shelter promoter, regardless of whether the IRS ultimately establishes a violation of I.R.C. § 6700. It would defeat the purpose of penalty relief in exchange for voluntary disclosure on a QAR if taxpayers could file a QAR after the IRS already had detected a tax shelter, making its disclosure no longer voluntary.

4. Taxpayers have conceded that they are liable for the accuracy-related penalty for 2001 in the amount of $41,196 if their amended return was not a QAR. The Tax Court made all of the factual findings

necessary to establish that the amended return was not a QAR under the correct interpretation of Treas. Reg. § 1.6664-2(c)(3)(ii), and taxpayers do not challenge those findings on appeal. The Tax Court's decision should therefore be affirmed. In the alternative, if the Court were to accept taxpayers' interpretation of Treas. Reg. § 1.6664-2(c)(3)(ii), a remand would be necessary for the Tax Court to make additional factual findings regarding whether KPMG's conduct rendered it subject to a penalty under I.R.C. § 6700.

ARGUMENT

The Tax Court correctly decided that taxpayers did not file a qualified amended return for 2001, and that, therefore, they were liable for the accuracy-related penalty imposed by the Commissioner under I.R.C. § 6662 because of their underpayment of tax, which was the result of their participation in a tax shelter

Standard of review

In its opinion, the Tax Court construed Treas. Reg. § 1.6664-2(c)(3)(ii) and made the factual findings necessary to apply the regulation, as construed, to taxpayers' amended return for 2001. (SER 18-26.) On appeal taxpayers challenge only the Tax Court's interpretation of Treas. Reg. § 1.6664-2(c)(3)(ii). This Court reviews *de novo* the Tax Court's interpretation of a Treasury regulation. *Metro*

Leasing & Dev. Corp. v. Commissioner, 376 F.3d 1015, 1021 (9th Cir. 2004); *UnionBanCal Corp. v. Commissioner*, 305 F.3d 976, 981 (9th Cir. 2002). By not challenging the Tax Court's factual findings in their opening brief, taxpayers have waived review thereof. *Padgett v. Wright*, 587 F.3d 983, 985 n.2 (9th Cir. 2009); *Independent Towers of Wash. v. State of Washington*, 350 F.3d 925, 929 (9th Cir. 2003).

A. Introduction

The Tax Court decided that taxpayers were liable for an I.R.C. § 6662(a) accuracy-related penalty for 2001 in the amount of $41,196. (SER 30.)

In 1989, Congress reorganized the Code's penalty regime by enacting the accuracy-related penalty (I.R.C. § 6662) and supporting definitions and special rules (I.R.C. § 6664) as part of the Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7721, 103 Stat. 2106, 2395–2400. Taken together, I.R.C. § 6662(a) and (b) impose a penalty equal to 20% of the portion of any underpayment of tax required to be shown on a return attributable, *inter alia*, to negligence, substantial understatement of tax, or any substantial valuation misstatement.

For present purposes, an underpayment is the amount by which a taxpayer's actual tax exceeds "the amount shown as the tax by the taxpayer on his return." I.R.C. § 6664(a). On December 31, 1991, the IRS promulgated Treas. Reg. § 1.6664-2(c) to further define the "amount shown as the tax by the taxpayer on his return." T.D. 8381, 1992-1 C.B. 374, 388-89. Section 1.6664-2(c) allows penalty relief if the taxpayer files a qualified amended return (QAR). A QAR is an amended return filed after the due date of the original return and before the earliest of a list of terminating events. Treas. Reg. § 1.6664-2(c)(3). If a taxpayer files a QAR, the amount shown as tax on his original return will include the amount shown as additional tax on the QAR, thereby reducing or eliminating the underpayment subject to the 20% penalty. Treas. Reg. § 1.6664-2(c)(2).

In the instant case, the earliest of the terminating events listed in Treas. Reg. § 1.6664-2(c) was what the Tax Court called the "promoter provision."[4] (SER 18-19.) As in effect on March 15, 2004, when

[4] The Commissioner acknowledged that taxpayers' amended return otherwise satisfied the requirements for a QAR. (SER 62.)

taxpayers filed their amended return, the promoter provision (Treas. Reg. § 1.6664-2(c)(3)(ii)) stated:

> (ii) The time any person described in section 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 section 6700(a) 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).

On March 2, 2005, the IRS issued Treasury Decision 9186, 2005-1 C.B. 790, 792, which promulgated a temporary regulation (effective for amended returns filed on or after March 2, 2005) changing the citation of the promoter provision and amending its text as follows (Temp. Treas. Reg. § 1.6664-2T(c)(3)(i)(B)):

> (B) The date any person is first contacted by the Internal Revenue Service 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).

Treasury Decision 9186 explained the amendment to the promoter provision as follows (2005-1 C.B. at 791-92):

> 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.

The subsequently issued final regulation is identical to the above-quoted temporary regulation, except that "Internal Revenue Service" is shortened to "IRS." Treas. Reg. § 1.6664-2(c)(3)(i)(B).[5]

The temporary regulation promulgated in Treasury Decision 9186 also added several new terminating events that would end the period for filing a QAR. 2005-1 C.B. at 792-93. Treasury Decision 9186 explained that the purpose of the QAR amendments was to "discourage the wait-and-see approach of some taxpayers and to encourage voluntary compliance," and that additional terminating events were "necessary because existing rules may encourage taxpayers to delay filing amended returns until after the IRS has taken steps to identify

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[5] Treas. Reg. § 1.6664-2(c)(3)(i)(B) applies to amended returns filed on or after March 2, 2005. Because taxpayers filed their amended return on March 15, 2004 (SER 48, 85), this regulation is inapplicable in this case. The applicable regulation is Treas. Reg. § 1.6664-2(c)(3)(ii), which is the regulation cited by the Commissioner in his briefs to the Tax Court (*see* SER 61) and by the Tax Court itself in its opinion (SER 19-20).

taxpayers as participants in potentially abusive transactions." *Id.* at 791.

B. The Tax Court correctly construed and applied the QAR terminating event found in the promoter provision of Treas. Reg. § 1.6664-2(c)(3)(ii)

1. The Tax Court did not erroneously rely on Treas. Reg. § 1.6663-2(c)(3)(i)(B)

Taxpayers argue (Br. 3-5, 8-13) that the Tax Court applied the wrong version of the promoter provision because, according to taxpayers, its paraphrase of that provision (SER 19-20) more closely tracks the text of the later Treas. Reg. § 1.6664-2(c)(3)(i)(B), instead of the applicable Treas. Reg. § 1.6664-2(c)(3)(ii). There is no basis for taxpayers' argument, which seeks to mask what is, in reality, simply their disagreement with the Tax Court's interpretation of Treas. Reg. § 1.6664-2(c)(3)(ii).

The Tax Court's opinion itself refutes the notion that the Tax Court applied the wrong version of the regulation. In its discussion of the terms of the regulation, the Tax Court cited the applicable version

of the regulation—Treas. Reg. § 1.6664-2(c)(3)(ii).[6] (SER 19.) The Tax Court also cited a District Court opinion that quoted Treas. Reg. § 1.6664-2(c)(3)(ii) in its entirety before rejecting the argument that the regulation required an activity that would subject a person to the imposition of an I.R.C. § 6700 penalty in order to terminate the period for filing a QAR. (SER 20 n.5.) *Sala v. United States*, 2007 WL 1970317 at *2 (D. Colo. 2007), *rev'd on other grounds*, 613 F.3d 1249 (10th Cir. 2010), *cert. denied*, 132 S. Ct. 91 (2011). As the district court in *Sala* explained, the issue was not whether a promoter satisfied requirements of I.R.C. § 6700, but instead when the promoter "was, pursuant to Section 1.6664-2, 'contacted' by the IRS with regard to an activity described in § 6700." *Ibid.*

Moreover, in their post-trial briefs, both parties quoted the applicable Treas. Reg. § 1.6664-2(c)(3)(ii) (SER 55-57, 61-62), and both parties informed the Tax Court that the promoter provision regulation had been amended, effective after the filing of taxpayers' amended return (SER 55-56, 61 n.3). Taxpayers also filed a motion to vacate the

[6] Nowhere in either of its opinions does the Tax Court cite the later, amended Treas. Reg. § 1.6664-2(c)(3)(i)(B). (*See* SER 1-10, 12-29.)

decision, in which they argued that the Tax Court had applied the wrong regulation. (SER 63-68.) In opposing the motion, the Commissioner explained that the parties had cited the correct version of the regulation in their briefs and that the Tax Court had cited to the applicable version of the regulation in its opinion. (SER 70-71.) The Commissioner further observed that there was no substantive difference between the version of the regulation applicable in this case and the later version of the regulation. (SER 71 n.4.) In particular, the Commissioner maintained that neither version of the regulation required proof that the person under investigation for the I.R.C. § 6700 penalty engaged in conduct that would subject him to the imposition of the I.R.C. § 6700 penalty in order to terminate the time in which a taxpayer may file a QAR. (SER 71-73.) The Tax Court's denial of taxpayers' motion to vacate, for the reasons stated in its opinion and in the Commissioner's opposition, can only be construed as a rejection of taxpayers' argument that the Tax Court had applied the wrong version of the regulation. (SER 31.)

2. The Tax Court correctly construed the applicable Treas. Reg. § 1.6664-2(c)(3)(ii)

As explained above, a taxpayer must file his amended return before the earliest of a list of terminating events for the amended return to be a QAR. As in effect on March 15, 2004, the date that taxpayers filed their amended return, Treas. Reg. § 1.6664-2(c)(3)(ii), provided as follows:

> (ii) The time any person described in section 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 section 6700(a) 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).

Taxpayers argue (Br. 4, 7-8, 10-13) that the phrases "person described in section 6700(a)" and "activity described in section 6700(a)" necessarily mean that the IRS must prove, in a taxpayer's I.R.C. § 6662, accuracy-related penalty proceeding, that the third-party shelter promoter and its activities satisfied all of the requirements to be penalized under I.R.C. § 6700, for an IRS contact of the promoter to

become a terminating event for a QAR.[7] Taxpayers further argue (Br. 11-13) that, because the Tax Court did not make I.R.C. § 6700 findings regarding KPMG[8]: (1) the March 19, 2002 summonses never qualified as a terminating event; (2) their amended return (filed on March 15, 2004) was a QAR; and (3) they should be relieved of the accuracy-related penalty.

Taxpayers' reading of the contested language in the regulation is not well founded. The Supreme Court has explained that "[t]he plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is

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[7] We do not understand taxpayers to be arguing that the shelter promoter must actually have been penalized under I.R.C. § 6700 for a first contact by the IRS to qualify as a terminating event. (*See* Br. 11.) It is unnecessary to address that interpretation of the promoter provision, however, because the applicable regulation does not even require proof that the promoter engaged in conduct that would subject him to a I.R.C. § 6700 penalty, much less require the actual imposition of such a penalty.

[8] Because the Tax Court rejected taxpayers' reading of Treas. Reg. § 1.6664-2(c)(3)(ii), it was not required to make I.R.C. § 6700 findings regarding KPMG. As discussed in part C, *infra*, such findings were proposed by the Commissioner to the Tax Court. If this Court were to adopt taxpayers' interpretation of Treas. Reg. § 1.6664-2(c)(3)(ii), a remand would be necessary for the Tax Court to consider those proposed findings in the first instance.

used, and the broader context of the statute as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997). In other words context can reveal which permissible meaning of a phrase "produces a substantive effect that is compatible with the rest of the law." *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988); *see also John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank*, 510 U.S. 86, 94-95 (1993) (statutory interpretation begins with statutory language guided not by single sentence or member thereof, but looking to text of entire law and to its object and policy); *Boeing Co. v. United States*, 258 F.3d 958, 967 (9th Cir. 2001) (tenets of statutory construction apply with equal force to interpretation of regulations), *aff'd*, 537 U.S. 437 (2003).

Treasury Regulation § 1.6664-2(c)(3) defines a QAR primarily in terms of its *timing*. To be a QAR, the amended return must be filed "before the earliest" of three terminating events. Each of the terminating events is triggered by the time some person or entity "is first contacted by the Internal Revenue Service" about an examination. Those events are: (i) the time the taxpayer "is first contacted by the Internal Revenue Service" concerning an examination of his return;

(ii) the time that a tax-shelter promoter "is first contacted by the Internal Revenue Service" concerning an examination about I.R.C. § 6700 penalties; or (iii) in the case of a pass-through item, the time that the pass-through entity "is first contacted by the Internal Revenue Service in connection with an examination of the return to which the pass-through item relates." Treas. Reg. § 1.6664-2(c)(3).

In this context, it makes little sense to read into the second terminating event the added requirement of penalty conduct that has nothing to do with the timing of the first IRS contact, since it is impossible to know at the time of first contact the ultimate result of the I.R.C. § 6700 investigation. Instead, in the context of Treas. Reg. § 1.6664-2(c)(3), the "described in" phrases of paragraph (ii) are best read as characterizing, for informational purposes, the type of person (a shelter promoter) and the type of audit (for the promoter penalty) involved. As the district court explained in *Sala*, the relevant issues are "the date the IRS notified [the promoter] it was under investigation and whether the scope of that investigation included the [subject] transaction." *Sala*, 2007 WL 1970317 at *2.

Any remaining ambiguity regarding the meaning of Treas. Reg. § 1.6664-2(c)(3)(ii) is resolved by the principle that an agency's interpretation of its own regulations is controlling, unless plainly erroneous or inconsistent with the regulatory text. *Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 171 (2007); *Auer v. Robbins*, 519 U.S. 452, 461 (1997); *Udall v. Tallman*, 380 U.S. 1, 16-17 (1965); *Siskiyou Reg'l Educ. Project v. U.S. Forest Serv.*, 565 F.3d 545, 554-55 (9th Cir. 2009). In Treasury Decision 9186, the IRS promulgated an amended version of the promoter provision intended to "clarify the existing rule[ ]" "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."[9] 2005-1 C.B. at 791-92. The IRS, therefore, interpreted its original version of the promoter provision as not imposing any requirement on it to prove that the promoter violated I.R.C. § 6700.

[9] Taxpayers concede that the amended regulation (Treas. Reg. § 1.6664-2(c)(3)(i)(B)) accomplished that clarification. (Br. 4.)

Treasury Decision 9186 also demonstrates that the amendments to I.R.C. § 1.6664-2(c)(3) arose out of the IRS's experience in administering the original regulations. *See Long Island*, 551 U.S. at 171 (deference accorded to interpretations reflecting agency's fair and considered judgment, but not to *post hoc* rationalizations of past agency actions); *Auer*, 519 U.S. at 462 (same); *Public Citizen v. Nuclear Reg. Comm'n*, 573 F.3d 916, 923 (9th Cir. 2009) (same). The IRS "determined that additional rules providing for the termination of the period for filing a qualified amended return are necessary because existing rules may encourage taxpayers to delay filing amended returns until after the IRS has taken steps to identify taxpayers as participants in potentially abusive transactions." T.D. 9186, 2005-1 C.B. at 791. The IRS also wanted "[t]o discourage the wait-and-see approach of some taxpayers and to encourage voluntary compliance." *Ibid.* The IRS's interpretation of its own promoter provision, therefore, is consistent with the regulatory text, reflects the IRS's considered judgment on the QAR regulations, and is entitled to controlling deference in this case.

Furthermore, the Tax Court's and the IRS's interpretation of the promoter provision comports with the purpose of QARs, whereas

taxpayers' interpretation does not. The I.R.C. § 6662 accuracy-related penalty serves, in part, to compensate the IRS for the additional cost of detecting and correcting accuracy-related errors on tax returns. "Civil penalties for additions to tax are remedial in nature and are primarily imposed to reimburse the Government for investigation expenses, to cover the monetary loss due to the taxpayer's fraud, and to protect revenue." *Schachter v. Commissioner*, 255 F.3d 1031, 1034 (9th Cir. 2001). *See also Helvering v. Mitchell*, 303 U.S. 391, 401 (1938). The QAR provisions in Treas. Reg. § 1.6664-2 provide an incentive for taxpayers to disclose errors voluntarily. In exchange for voluntarily reporting an error on a QAR—thereby sparing the IRS the cost of detecting and correcting the error—the IRS will reduce or forego what could be a sizable accuracy-related penalty. That incentive fails, however, if taxpayers who participated in a tax shelter can wait to see if the IRS will detect the shelter, file an amended return after the IRS has learned through its own efforts and at its own expense of the shelter (and disclosure would no longer be voluntary), and then hope to benefit from the QAR regulations if the IRS decides, for whatever reason, not to pursue an I.R.C. § 6700 penalty case against the promoter.

3. Taxpayers are liable for the accuracy-related penalty under the Tax Court's correct interpretation of Treas. Reg. § 1.6664-2(c)(3)(ii)

Taxpayers have conceded that they are liable for the accuracy-related penalty for 2001 in the amount of $41,196 if their amended return was not a QAR. (SER 50.) The Tax Court made all of the factual findings necessary to establish that taxpayers' amended return was not a QAR, and taxpayers do not challenge any of those findings on appeal. *Padgett*, 587 F.3d at 985 n.2 (issues not raised in opening brief not ordinarily considered on appeal); *Independent Towers*, 350 F.3d at 929 (same).

Taxpayer was a partner in the Stratecon group of the KPMG accounting firm. (SER 14, 33-34.) With the assistance of fellow partner David Greenberg, taxpayer in 2000 and 2001 engaged in SOS-like shelter transactions, which were the same as, or substantially similar to, transactions described in IRS Notice 2000-44, 2000-2 C.B. 255 (transactions generating losses by artificially inflating basis). (SER 14-16, 24-26, 37-45.)

On March 19, 2002, the Commissioner served two summonses on KPMG. (SER 76-78; *see also* SER 17, 46-48.) The Tax Court found that

the service of the summonses was a terminating event under the promoter provision. To wit: (1) the summonses "explicitly stated that they concerned the liability of KPMG under section 6700" (SER 20-21); (2) Greenberg was acting as KPMG's agent in organizing and coordinating taxpayers' 2000 and 2001 shelter transactions, making those transactions attributable to KPMG (SER 21-24); and (3) the summons that invoked Notice 2004-44, *supra*, covered taxpayers' 2000 transaction (SER 24-26).

On March 15, 2004, almost two years later, taxpayers filed their amended return for 2001. (SER 17-18, 48-49, 85-87.) By then, however, it was too late for the amended return to be a QAR.

The decision of the Tax Court that the amended return was not a QAR and that, consequently, taxpayers are liable for the accuracy-related penalty for 2001 is correct and should be affirmed.

C. In the alternative, if the Court were to accept taxpayers' interpretation of Treas. Reg. § 1.6664-2(c)(3)(ii), a remand would be necessary for the Tax Court to make additional factual findings regarding I.R.C. § 6700

Taxpayers argue (Br. 11-13) that, because the Tax Court did not make factual findings regarding whether KPMG satisfied the requirements of I.R.C. § 6700(a)(2), they are entitled to a judgment as a

matter of law if this Court agrees with their interpretation of Treas. Reg. § 1.6664-2(c)(3)(ii). The parties, however, disputed in the Tax Court whether KPMG and its activities were described in I.R.C. § 6700. (*See* SER 53-54, 59-60.) The Tax Court was not required to resolve that dispute because it was irrelevant under the court's correct interpretation of Treas. Reg. § 1.6664-2(c)(3)(ii). Therefore, if this Court were to agree with taxpayers' interpretation of Treas. Reg. § 1.6664-2(c)(3)(ii), the case should be remanded to the Tax Court to resolve those factual issues.

As applicable here, I.R.C. § 6700(a) imposes a penalty an any person who: (1) "organizes (or assists in the organization of)" or "participates (directly or indirectly) in the sale of any interest in an entity or plan or arrangement" and (2) "makes or furnishes or causes another person to make or furnish" in connection with such 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 knows or has reason to know is false or fraudulent as to any material matter."

The parties stipulated that "KPMG is a person who performed activities described in I.R.C. § 6700(a)(1) regarding the SOS transactions it promoted to its clients"; that "Mr. Greenberg is a person who performed acts described in I.R.C. § 6700(a)(1) regarding the SOS type transactions implemented by KPMG's clients"; and that "[i]n addition, Mr. Greenberg assisted some KPMG partners in their implementation of SOS type transactions for their personal use." (SER 35-37.) The Tax Court made the finding (unchallenged on appeal) "that Greenberg was acting as an agent for KPMG with respect to [taxpayers'] 2000 transaction and 2001 transaction." (SER 24.) It follows from those stipulations and that unchallenged factual finding (and taxpayers appear to admit (*see* Br. 11-12)) that KPMG was a person described in I.R.C. § 6700(a)(1) with respect to taxpayers' transactions, which involved an entity, plan, or arrangement described in I.R.C. § 6700(a)(1).

The record also contains evidence from which the Tax Court could have reasonably found that KPMG is a person described in I.R.C. § 6700(a)(2). For example:

- As part of the SOS-like transactions that he set up for taxpayers and other KPMG partners, Greenberg arranged for Steven M. Corbin, a certified public accountant, to provide tax opinions to participants who requested such opinions and paid Mr. Corbin for them. (SER 41, 44; CR 82 at 198, 200-01.)
- Corbin's tax opinions were based on opinions prepared by Greenberg. (*Compare* Exs. 1-R, 2-R *with* Exs. 14-R, 20-R.)
- Taxpayers' SOS-like transactions were shams lacking in economic substance and designed only to generate tax benefits. (*See* SER 34-35, 37-45.)
- As an experienced tax professional, Greenberg knew or had reason to know that the statements made to clients and his partners concerning the tax shelter were false or fraudulent. (*See* SER 34; CR 81 at 133-39.)

Therefore, there is evidence in the record from which the Tax Court could reasonably find that Greenberg (and, by extension, KPMG) made or caused another to make statements regarding the tax benefits of the SOS-type transactions, with knowledge or reason to know of the

statements' falsity or fraudulence with respect to the material matter of the tax benefits to be derived from the transactions.[10]

Accordingly, in the event this Court were to agree with taxpayers' interpretation of Treas. Reg. § 1.6664-2(c)(3)(ii), it should remand this case for further factual findings by the Tax Court regarding whether KPMG's conduct fell within the scope of I.R.C. § 6700.

[10] The above-cited evidence is more than enough to satisfy the Commissioner's I.R.C. § 7491(c) burden of production. (*See* Br. 13.)

CONCLUSION

The Tax Court's decision is correct and should be affirmed. In the alternative, this case should be remanded for further factual findings on the issue whether KPMG is a person described in I.R.C. § 6700(a).

Respectfully submitted,

KATHRYN KENEALLY
Assistant Attorney General

/s/ Anthony T. Sheehan

RICHARD FARBER (202) 514-2959
ANTHONY T. SHEEHAN (202) 514-4339
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044
Appellate.Taxcivil@usdoj.gov
Anthony.T.Sheehan@usdoj.gov

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STATEMENT OF RELATED CASES

Pursuant to Ninth Circuit Rule 28-2.6, counsel for the Commissioner respectfully inform the Court that they are not aware of any prior or related cases other than the suspended Tax Court case listed in taxpayers' opening brief (Br. 14).

CERTIFICATE OF COMPLIANCE

With Type-Volume Limitation, Typeface Requirements, and Type Style Requirements of Federal Rule of Appellate Procedure 32(a)

Case No. 12-70259

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because:

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(s) /s/ Anthony T. Sheehan

Attorney for Commissioner of Internal Revenue

Dated: August 1, 2012

CERTIFICATE OF SERVICE

I hereby certify that on August 1, 2012, I electronically filed the foregoing brief with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system. I further certify that all participants in the case are registered CM/ECF users, and that service will be accomplished by the appellate CM/ECF system.

/s/ Anthony T. Sheehan
ANTHONY T. SHEEHAN
Attorney