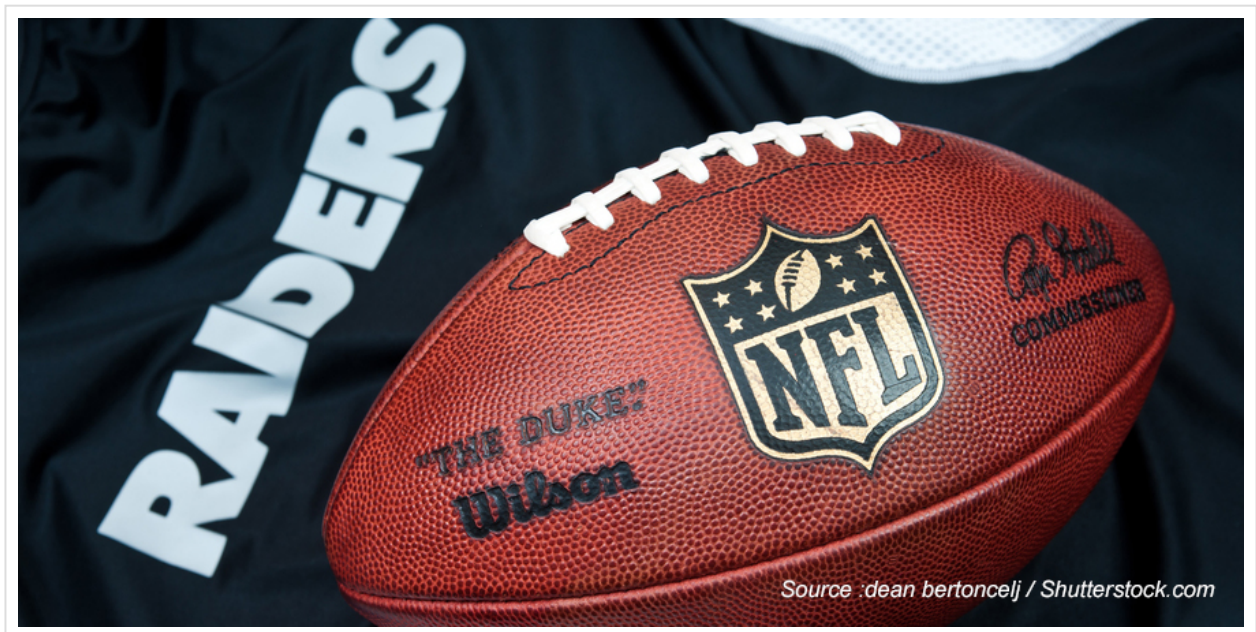




TAX PROCEDURE: IRS FAILURE TO COMPLY WITH A CLOSING AGREEMENT DOES NOT INVALIDATE A TAX ASSESSMENT

Posted on **January 29, 2016** by **Jim Malone**



The late [Al Davis](#), former owner of the Oakland Raiders, was a big fan of a Hail Mary: Davis liked them on the football field, and he liked them in the courtroom too. Recently, his estate attempted one, arguing that a technical violation of a closing agreement by the IRS invalidated a tax assessment, but the effort fell short. [Davis v. United States](#), 2016 U.S. App. LEXIS 1167 (9th Cir. Jan 25, 2016).

While Davis was the public face of the Oakland Raiders for many years, the team was actually owned by a limited partnership (the “Partnership”), in which Davis held the largest interest; Davis was also the president of A.D. Football, Inc., which was the general partner of the partnership and its tax matters partner. [Davis](#), 2016 U.S. App. LEXIS 1167 at *4-*5. The Partnership and the IRS were involved in protracted litigation that resulted in a 2005 settlement covering tax years 1988 through 1994. This was memorialized in a closing agreement that Davis signed as president of the tax matters partner for the Partnership. *Id.* at *5.

The closing agreement provided for the IRS to make computational adjustments that would determine the effect of the settlement on each partner’s tax liability. The agreement gave each partner in the Partnership 90 days to review and comment on proposed computational adjustments, and another 60 days to review any revisions before the IRS would issue an assessment. *Id.* at *6. The related Tax Court case was then settled through a series of stipulations entered by the court for the relevant tax years in June 2006, each of which indicated that the Court’s decision was

entered subject to the terms of the closing agreement. *Id.*

A problem arose because the IRS was slow to distribute its computational adjustments. After it received comments from Davis, it did not have enough time to give him the required 60 days to review the revised computations because the assessment statute of limitations period was due to expire. *Id.* at *6-*7. As a consequence, the IRS simply issued assessments in September 2007. *Id.* at *7.

Davis filed refund claims, one of which the IRS denied and one of which it ignored. *Id.* at *7-*8. Davis then brought suit in the Northern District of California, which granted his summary judgment motion after concluding that the government's failure to comply with the closing agreement invalidated the tax assessments. *Id.* at *8. On appeal, the government conceded that it had breached the closing agreement, but argued that the violation did not invalidate the tax assessments.

The Ninth Circuit commenced its analysis by noting that closing agreements are contracts and that the presumptive remedy for a contractual breach is damages. *Id.* at*8-*9 (citations omitted). The Court expressed skepticism about the argument that the appropriate remedy was to invalidate the assessments, noting that "Davis offers no support for the unlikely proposition that . . . the remedy for any breach, however small, is to free the taxpayer from his pre-existing obligation to pay taxes." *Id.* at *10.

The Ninth Circuit distinguished *Philadelphia & Reading Corp. v. United States*, 944 F.2d 1063 (3d Cir. 1991), explaining that the taxpayer's contractual waiver of a notice of deficiency was not triggered in that case, which meant that the assessments violated the Internal Revenue Code because no deficiency notice was issued to the taxpayer. *Davis*, 2016 U.S. App. LEXIS 1167 at *11 (citing *Philadelphia & Reading Corp.*, 944 F.2d at 1072-73). In contrast, the assessments entered in Davis did not violate the Code, they merely breached the closing agreement.

In the Ninth Circuit's view, the closing agreement simply specified how certain partnership items would be calculated for the purpose of determining tax liability; the obligation to pay the taxes due came from the Internal Revenue Code, and the closing agreement did not provide that "any taxes assessed on the partners pursuant to statute would be rendered invalid if the government did not perform." *Id.* The Court of Appeals stressed that Davis had suffered minimal prejudice; while the government's violation of the closing agreement eliminated his opportunity to comment on the revised computational adjustments, he still was free to challenge the ultimate tax assessments. *Id.* at *12.

After disposing of the assertion that the government's violation of the closing agreement invalidated the relevant tax assessments, the Ninth Circuit addressed the question whether the assessments were timely. Here, the issue turned on whether the closing agreement and the associated Tax Court stipulation constituted an agreement with the partners in the Partnership or an agreement with the Partnership that became binding on the individual partners as parties to the Tax Court litigation when the court entered the stipulations.

While this may sound like hairsplitting, it was outcome-determinative:

- If the closing agreement and Tax Court stipulations constituted an agreement with the partners, then the computational adjustments became non-partnership items under Section 6231(b)(1)(C) of the Code, and the IRS had one year to assess additional taxes running from the date the Tax Court stipulations were signed under Section 6229(f)(1) of the Code. This would have made the September 4, 2007 tax assessments untimely because the approval of the settlement by the Tax Court occurred on June 6, 2006. See *id.* at *15-*16.
- In contrast, if the closing agreement and Tax Court stipulations constituted a settlement with the Partnership that bound the partners because they were parties to the Tax Court case, the one year assessment statute would begin to run 90 days later, when the Tax Court's decision became final. *Id.* at *15 (citations omitted).

The Court rejected the contention that the case involved a settlement between the IRS and the partners. Instead, it concluded that a settlement with a tax matters partner was not a settlement between the IRS and a partner; this meant the assessments fell just inside the one year limitations period. *Id.* at *16-*17. Accordingly, the Ninth Circuit reversed the district court.

The Court of Appeals was clearly influenced by what it viewed as a hyper-technical effort to avoid paying taxes. It noted that Davis could have challenged the amount of the tax assessments, but did not do so, and it also noted that if Davis had challenged the assessment amounts he might have recovered damages because the IRS forced him to pursue a more expensive route to challenge the relevant computational adjustments. *Id.* at *12.

The Court concluded that Davis had elected to pursue a high risk gamble instead of pursuing his available remedies: "he threw a Hail Mary and sought a full refund. That pass falls incomplete." *Id.*

Sounds like a good call.



By: **Jim Malone**

Jim Malone is a tax attorney in Philadelphia and Co-Chair of Post & Schell's [Tax Controversy Practice Group](#). He focuses his practice on federal, state and local tax controversies. [Learn more about Post & Schell's Tax Controversy Group >>](#)

6

This entry was posted in [Blog](#) and tagged [closing agreements](#), [tax procedure](#) by [Jim Malone](#). Bookmark the [permalink](#) [<http://taxcontroversyposts.postschell.com/tax-procedure-irs-failure-to-comply-with-a-closing-agreement-does-not-invalidate-a-tax-assessment/>].