

Before You File in Tax Court: Should Your Client Take the IRS to a Jury?

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When the IRS proposes a substantial tax liability, many taxpayers and their advisers instinctively assume that the next step is the United States Tax Court. That is often the correct forum. Tax Court lets taxpayers challenge a deficiency without first paying and also offers access to judges who deal with federal tax law every day.

But Tax Court is not the only option. In an appropriate case, a taxpayer may instead pay the disputed liability, file an administrative refund claim, and bring a refund suit in federal district court. Unlike Tax Court, a federal district court can provide something potentially significant: a trial before a local jury.

That alternative may be especially important when the taxpayer's dispute falls within a category that the IRS has publicly targeted and in which the Tax Court has developed a substantial body of government-favorable precedent. Captive-insurance arrangements, Puerto Rico tax-incentive cases, conservation easements, listed transactions, and transactions of interest are prominent examples.

Sometimes the Forum Is as Important as the Tax Issue

I often say that jury trials are, at least in part, popularity contests — and it is hard to lose a popularity contest to the IRS.

A jury may be particularly receptive when a taxpayer can present credible witnesses, contemporaneous business records, and a logical explanation for the transaction under examination. When the IRS's position depends on portraying a legitimate business, its owners, or its advisers as abusive or dishonest, a local jury may provide a valuable opportunity to test that characterization.

This does not mean that a jury will disregard the law or automatically side with the taxpayer. The taxpayer must still establish the elements necessary to recover a refund, and the district judge will decide the governing legal questions.

But when the outcome depends heavily on facts, credibility, and business reality, the identity of the factfinder matters.

The Concern Is Greatest in Heavily Targeted Categories

Every tax case should be decided on its own facts. In practice, however, prior decisions inevitably shape how later cases are evaluated.

That becomes particularly significant when the Tax Court has repeatedly considered a particular type of transaction and consistently ruled in the government's favor. Over time, the disputed category can acquire a negative identity of its own. A taxpayer may then face not only the evidence in its particular case, but also an existing body of decisions involving other

taxpayers, different advisers, different documents, and different facts.

Captive-Insurance Arrangements

The Tax Court has decided a series of micro-captive cases in favor of the government. Those decisions have developed a body of precedent addressing risk distribution, actuarial pricing, claims administration, circular cash flows, risk pools, and whether the arrangements constitute insurance in the commonly accepted sense.

Many of the arrangements addressed in those opinions had significant factual weaknesses. Nevertheless, the accumulation of adverse decisions can make it difficult for a taxpayer with materially different facts to separate its case from the broader category.

Once “micro-captive” or “§ 831(b)” appear in the case, the taxpayer may find itself defending not only its own insurance program but the reputation of the industry as a whole.

Puerto Rico Tax-Incentive Cases

The IRS has established a compliance campaign directed at taxpayers claiming benefits under Puerto Rico Acts 20 and 22, now incorporated into Act 60. The campaign addresses whether taxpayers were bona fide residents of Puerto Rico, whether income was properly sourced to Puerto Rico, and whether particular structures improperly shifted income away from the United States.

The IRS has committed examination resources, technical guidance, data analysis, and other enforcement tools to these cases. Its published materials identify perceived noncompliance involving both residency and income sourcing.

As these cases move from examination into litigation, taxpayers may confront a government narrative that treats the Puerto Rico incentive structure itself with suspicion. Yet the critical questions — where the taxpayer lived, where services were performed, how the business operated, and where the income was earned — are often highly factual. A jury may evaluate those questions through testimony, business records, travel records, communications, and other contemporaneous evidence.

Conservation Easements

Conservation-easement litigation has likewise produced a substantial body of government-favorable decisions. Many cases involve technical deed requirements, valuation disputes, partnership structures, promotional materials, and questions concerning the taxpayer’s charitable intent.

The IRS has publicly identified abusive syndicated conservation easements as an enforcement priority. That designation can influence how the transaction is perceived before the taxpayer’s particular facts are examined.

A jury will not cure a defective deed or disregard an applicable statutory requirement. But where the dispute turns on valuation, intent, reasonable reliance, or the credibility of competing experts, jury review may offer a materially different forum.

Listed Transactions and Transactions of Interest

The same concern applies more broadly to listed transactions and transactions of interest.

An IRS designation creates reporting obligations and potentially significant penalties, but it does not establish that every taxpayer participating in the transaction acted improperly. Nor does it prove that the IRS’s proposed tax treatment is correct in every case.

Nevertheless, the designation itself can become a central feature of the dispute. The taxpayer may be viewed as a participant in an abusive strategy before the court considers the specific facts, legal advice, business purposes, and economic consequences of the transaction.

In those circumstances, presenting the case to a jury without the same history of category-specific Tax Court decisions may be strategically important.

Tax Court and District Court Offer Different Paths

A taxpayer who receives a statutory notice of deficiency may petition the Tax Court without paying the proposed liability. The case is decided by a Tax Court judge, not a jury.

Alternatively, the taxpayer may allow the liability to be assessed, pay the amount required to pursue a refund action, file a proper administrative claim for refund, and, after satisfying the applicable procedural requirements, bring suit in federal district court. Federal law gives district courts jurisdiction over qualifying federal tax-refund suits, and either party may request a jury trial.

The taxpayer may also bring a refund suit in the United States Court of Federal Claims, but that court does not provide a jury. When jury review is part of the litigation strategy, federal district court is therefore the relevant alternative.

The Principal Drawback: Payment Usually Comes First

The most obvious advantage of Tax Court is that the taxpayer ordinarily does not have to pay the asserted deficiency before obtaining judicial review.

A district-court refund suit generally works in the opposite order. Under the Supreme Court's full-payment rule, the taxpayer ordinarily must pay the assessed tax before filing suit to recover it. For a large deficiency, that can create a substantial financial burden and may make the district-court route impractical.

There are important exceptions for certain divisible taxes and penalties. Employment taxes, trust-fund recovery penalties, and some assessable penalties may permit refund litigation after payment of only the divisible portion required by the applicable statute. Internal Revenue Code § 6703 also provides a special procedure for challenging certain promoter penalties, including penalties under § 6700.

The payment requirement must therefore be evaluated based on the particular tax or penalty. CPAs should not assume either that the entire assessment must always be paid or that a partial payment will necessarily be sufficient.

Where the taxpayer has access to the necessary funds, or where a divisible assessment permits a more limited payment, the strategic value of a jury may justify the cost of pursuing the refund route.

***Ankner* Demonstrates the Value of Escaping a Category-Based Narrative**

The potential value of a district-court jury was illustrated in *Ankner v. United States*, where I served as lead trial counsel for a captive-insurance manager and its chief executive officer in their successful challenge to approximately \$4 million in promoter penalties imposed under § 6700.

Although *Ankner* involved promoter penalties rather than a direct challenge to captive-insurance deductions, the government's theory depended on its characterization of the underlying micro-captive arrangements. The verdict represented the first courtroom victory for a taxpayer in the § 831(b) micro-captive arena and, to date, remains the only taxpayer victory — standing apart from an otherwise uninterrupted series of government victories in Tax Court.

After making the payment required to invoke the special statutory refund procedure, the taxpayers challenged the penalties in the United States District Court for the Middle District of Florida.

At trial, the government could not prevail merely by characterizing the underlying arrangements as micro-captives or relying on adverse decisions involving other taxpayers. It was required to prove the specific statutory elements of § 6700 based on the

evidence involving these taxpayers.

The jury heard the witnesses, reviewed the documents, and considered what the taxpayers had actually said, what they knew, and whether the statements identified by the government were materially false. The jury rejected the government's position and found that the taxpayers were not liable for the penalties.

The lesson is not that juries will always rule for taxpayers. It is that a jury can require the parties to move beyond the label attached to a transaction and return the focus to the particular witnesses, documents, representations, and business facts in the case.

Although the burden of proof in *Ankner* was governed by the provisions applicable to § 6700 penalties, the broader lesson applies to other disputes: an IRS enforcement designation or a series of adverse cases involving other taxpayers should not replace individualized consideration of the evidence.

The Refund Claim Should Be Prepared With Litigation in Mind

Choosing district court requires more than paying the assessment.

Internal Revenue Code § 7422 generally requires the taxpayer to file an administrative refund claim before bringing suit. The claim should identify each ground on which the refund is sought and provide sufficient facts to advise the IRS of its basis.

The refund claim should therefore be prepared as the foundation for potential litigation. Counsel should consider the legal theories, relevant tax periods, supporting documents, potential witnesses, and expert issues before the claim is filed.

A strong refund claim may also improve the prospects for resolving the dispute administratively. It demonstrates that the taxpayer has developed the case, understands the evidentiary requirements, and is prepared to proceed if the IRS does not allow the refund.

The Forum Decision Must Be Made Early

The choice between Tax Court and district court should not be postponed until the eve of trial.

When the IRS issues a statutory notice of deficiency, the taxpayer ordinarily has 90 days to file a Tax Court petition. Filing that petition generally forecloses a later district-court refund action involving the same tax and period. The taxpayer and its advisers should therefore evaluate the competing forums before the petition is filed.

If the taxpayer selects the refund route, the administrative claim and the limitations period for filing suit must also be monitored carefully. Once the IRS mails a formal notice of disallowance, Internal Revenue Code § 6532(a) generally provides two years to file suit. Continuing to negotiate with the IRS or pursuing an administrative appeal does not, by itself, extend that deadline.

When CPAs Should Raise the Issue

CPAs are often in the best position to recognize cases that may benefit from district-court review. They understand the client's business, know the quality of the records, and can evaluate whether the taxpayer and other witnesses can credibly explain the disputed transaction.

The forum question deserves consideration when:

- The IRS appears to be applying an industrywide enforcement position rather than focusing on the taxpayer's individual facts
- The dispute turns heavily on credibility, intent, valuation, reasonable reliance, or business purpose
- The client has strong witnesses and contemporaneous documentation

- The client's business explanation can be communicated clearly to non-tax specialists
- Payment is financially possible, or a divisible-tax procedure may reduce the required payment
- The deadline for filing a Tax Court petition is approaching

These factors do not mean district court is necessarily the better forum. A dispute involving a narrow statutory interpretation or an issue driven principally by specialized tax doctrine may be better suited to a Tax Court judge. But a fact-intensive case with a strong record and an unfavorable category-based narrative should prompt a deliberate forum analysis.

A CPA does not need to determine the proper forum. The CPA needs to recognize when the choice deserves a conversation with litigation counsel before the available options narrow.

Do Not Treat Tax Court as the Automatic Choice

Tax Court remains an important and frequently appropriate forum. Its prepayment jurisdiction and specialized judges offer substantial advantages.

But when a taxpayer has materially better facts than the cases that preceded it, the ability to present those facts to a local jury may offer meaningful strategic value. The question should be considered before Tax Court becomes the automatic, and potentially irrevocable, choice.

As *Ankner* demonstrates, moving beyond the IRS's label and focusing the factfinder on the taxpayer's actual evidence can change the outcome.