

## DEPARTMENT OF THE TREASURY INTERNAL REVENUE SERVICE WASHINGTON, D.C. 20224

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SB/SE),

SALT LAKE CITY CC:SB:5:SLC

FROM: Deborah A. Butler

Associate Chief Counsel

(Procedure and Administration) CC:PA

SUBJECT: Abusive Trust Cases

This Chief Counsel Advice responds to your request for advice. Chief Counsel Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

# ISSUE:

Whether the memorandum proposed by Area Counsel, through the National Field Coordinator for the National Abusive Trust Project, should be issued and a sample motion to dismiss for failure to state a claim upon which relief can be granted and a sample motion to withdraw the motion to dismiss for failure to state a claim can be posted on the abusive trust website?

#### CONCLUSION:

The memorandum should be issued and the sample motion to dismiss for failure to state a claim upon which relief can be granted and the sample motion to withdraw the motion to dismiss for failure to state a claim can be posted on the abusive trust website subject to the following recommendations.

## FACTS:

Numerous Tax Court petitions have been filed in abusive trust cases where petitioners allege frivolous arguments in the documents filed as petitions which do not comport with the Rules of Practice and Procedure of the Tax Court as to the form and content and thus, fail to state a claim upon which relief can be granted. These abusive trust cases are typically related "whipsaw" cases in which the

Internal Revenue Service (Service) asserts alternative and inconsistent positions in order to protect the Service's interest in ultimately assessing and collecting the proper taxes from the proper persons or entities. The Service determines that the trusts are shams or in the alternative, grantor trusts owned by the individual, and that all income from the trusts are attributable to the individual. To protect the Service's position, deficiencies are also determined against the trusts by leaving in place all income reported by the trusts while disallowing the purported deductions for failure to substantiate.

In numerous instances, Counsel attorneys have filed motions to dismiss for failure to state a claim upon which relief can be granted which resulted in decisions on the merits in both the individual and trusts cases. The Tax Court has been somewhat troubled by entering decisions effectively upholding both sides of the Service's whipsaw determinations. However, by entering the full amount of the deficiency against the individual while simultaneously entering zero deficiency decisions against the trusts, the Service could lose the benefit of the whipsaw against the trusts should the individual appeal his/her case. Furthermore, in some instances motions to dismiss for failure to state a claim have been filed where the capacity of the purported trustee to bring the action has not been established. Area Counsel, through the National Field Coordinator for the National Abusive Trust Project, requested our review of the following: a memorandum notifying field SBSE attorneys working abusive trust cases of the problem; a sample motion to dismiss for failure to state a claim upon which relief can be granted which will be posted on the abusive trust website; and a sample motion to withdraw the motion to dismiss for failure to state a claim which will be posted on the abusive trust website.

The memorandum advises that when the Service issues whipsaw notices and both the individuals and trusts file petitions which fail to state a claim: Counsel should file a motion to dismiss for failure to state a claim upon which relief can be granted against the individual, but not against the trusts: Counsel can file motions to dismiss against the trusts based on jurisdictional grounds at any time; motions to dismiss based upon the pleadings (such as motions to dismiss for failure to state a claim and motions for a more definite statement) should not be filed against the trusts until the Tax Court has disposed of any motion to dismiss for failure to state a claim filed against the related individual (this will typically necessitate answering the trust cases); after the decision of the Tax Court involving the individual's case has become final, Counsel may take appropriate action against the trusts based on the facts of the case, which may include taking no action against the trusts until the case reaches a trial calendar, conducting discovery to determine whether the trustee has authority to file the petition, conceding the trust case, or any other action deemed appropriate; and if motions to dismiss for failure to state a claim have already been filed against individuals and their related trusts, consideration should be given to withdrawing the motions against the trusts.

#### LAW AND ANALYSIS

In the first sentence of the Statement of the Problem section of the proposed memorandum, you state that "numerous petitions have been filed in abusive trust cases, which make nothing but typical tax protest arguments." In the first sentence of the last paragraph on page 2 of the memorandum, you use the language "typical tax protest arguments." In paragraph 3 on page 2 and paragraph 5 on page 3 of your sample motion to dismiss for failure to state a claim, you use the language "frivolous tax protestor arguments." In paragraph 9 on page 29 of your sample motion to dismiss for failure to state a claim, you use the language "tax protest arguments." While these characterizations would not be considered violations of section 3707 of the Internal Revenue Service Restructuring and Reform Act of 1998, we recommend that you avoid language such as "tax protest" or "tax protestor."

The advice in the memorandum that motions to dismiss based upon the pleadings should not be filed against the trusts until the Tax Court has disposed of any motion to dismiss for failure to state a claim filed against the related individual should be clarified. Pursuant to Tax Court Rule 36(a), Counsel has 45 days from the service of a petition within which to make a motion to dismiss for failure to state a claim or motion for a more definite statement. After that time period, Counsel cannot not file the aforementioned motions but may file a motion for judgment on the pleadings should the pleadings fail to state a claim (assuming the Tax Court has jursidiction).

The advice in the memorandum that after the decision of the Tax Court involving the individual's case has become final, Counsel may take appropriate action against the trusts based on the facts of the case should be clarified. In every case, the purported trustees have to establish their capacity to bring the action.

Finally, we recommend that your memorandum advise that any motion to withdraw should be reviewed by Administrative Provisions and Judicial Practice, Branch 3

As a general matter, your proposed sample motion to dismiss for failure to state a claim is cumbersome and may be difficult to adapt to a particular case. We have found that motions to dismiss for failure to state a claim filed in the past by the various Counsel offices have been sufficient. For the sake of simplicity, we recommend that you set out the various responses to the frivolous arguments in a separate document also to be posted on the website. This will allow Counsel to use the bare bones motion without having to delete most of the paragraphs. Counsel could then cut and paste any appropriate response from the other document. You will also have to correct the numerous typographical and citation errors contained in your motion.

Paragraph 4 on page 3 of your sample motion to dismiss for failure to state a claim provides "If petitioner is alleging that the Court has no jurisdiction in this case, then the petitioner obviously had no intention of petitioning the Court for the redetermination of the deficiencies herein and the case should be dismissed because there was no intent to file a petition." This paragraph is misleading in that it implies that the Court's jurisdiction depends upon the intent of the petitioner. We recommend that this paragraph be deleted.

We recommend that you delete footnote 3 on page 23 since it is editorial in nature.

If you have any further questions, please call Administrative Provisions and Judicial Practice, Branch 3, at (202) 622-7940.

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