

POINTSTO REMEMBER

DOES THE BURDEN OF PROOF MATTER?

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Section 7491 places the burden of proof "on the Service, but only if, among other requirements, the taxpayer introduces credible evidence with respect to [the] factual issue" The statute does not define "credible evidence" but the legislative history states:

Credible evidence is the quality of evidence which, after critical analysis, the court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted (without regard to the judicial presumption of IRS correctness). A taxpayer has not produced credible evidence for these purposes if the taxpayer merely makes implausible factual assertions, frivolous claims, or tax protestor-type arguments. The introduction of evidence will not meet this standard if the court is not convinced that it is worthy of belief.

H. Conf. Rept. 105-599, at 240-241 (1998), 1998-3 C.B. 747, 994-995.

Thus, if the taxpayer presents no credible evidence on an issue, the burden of proof on that issue cannot shift to the Service under section 7491. *See Higbee v. Commissioner*, 116 T.C.

438, 443 (2001). However, the converse should not be true; if the taxpayer presents evidence such that the burden shifts, the taxpayer will not necessarily prevail on that issue. Nevertheless, recent litigation shows that such a shift can indeed change the outcome of the case. *See Griffin v. Commissioner*, T.C. Memo. 2002-6, *rev'd*, 315 F.3d 1017 (8th Cir. 2003), *on remand*, T.C. Memo. 2004-64.

In *Griffin*, Robert and Julia Griffin argued that they were entitled to deduct certain delinquent real property taxes paid with respect to property owned by two partnerships in which their wholly owned S corporation was a partner. In the Service's view, the taxpayers' payments were capital contributions to the partnerships via the S corporation and deductible expenses of the partnerships. The partnerships' expenses passed through to the partners, but the taxpayers' S corporation owned only 60 percent interests in the partnerships, so, under the Service's approach, the taxpayers would lose 40 percent of their deductions.

For the taxpayers to deduct the payments under section 162, the payments

had to be ordinary and necessary business expenses of the taxpayers. For a taxpayer to deduct payment of the expense of another, case law requires that (1) the taxpayer be engaged in a trade or business and (2) the payment to be an ordinary and necessary expense of that business. The second element, in turn, requires that (a) the entity actually liable—in *Griffin*, the partnerships—lacked the resources to pay and (b) failure to pay would have damaged the taxpayer's business. *See Griffin v. Commissioner*, T.C. Memo. 2002-6 (*Griffin I*) (citations omitted).

"The evidence in [the] case consisted . . . of 18 numbered stipulations of fact, 4 joint exhibits, and direct and cross-examination testimonies of Mr. Griffin and Mr. William LaRue, petitioners' accountant and tax return preparer" *Griffin v. Commissioner*, T.C. Memo. 2004-64 n.4 (*Griffin II*). In its initial opinion, the Tax Court described the evidence on the first element above as "sparse" and stated that "[t]he only evidence regarding the nature of petitioners' business activities consists of petitioner's summary and uncorroborated testimony." *Griffin I*. The court therefore held that the evidence "would

not be ‘sufficient upon which to base a decision on the issue’” *Id.* (quoting H. Conf. Rept. 105-599, at 240, 1998-3 C.B. at 994). The Tax Court also noted that, based on the preponderance of the evidence, its decision on the underlying issue would be the same, even if the Service bore the burden of proof. *See id.* n.4. It also found “no credible evidence that the tax payments represented ordinary and necessary expenses of any such trades or businesses.” *Id.* Specifically, the Tax Court found no evidence supporting the two aspects of the second element above. *See id.*

On appeal, the Court of Appeals for the Eighth Circuit reversed. *Griffin v. Commissioner*, 315 F.3d 1017 (8th Cir. 2003). That court applied the same definition of “credible evidence” but emphasized that such evidence is “the quality of evidence which, after critical analysis the court would find sufficient upon which to base a decision on the issue *if no contrary evidence were submitted*” *Id.* at 1021 (quoting Brief for Appellee at 22) (emphasis in original).

The Court of Appeals further stated, “[v]iewing Robert Griffin’s testimony in the absence of any evidence or presumptions to the contrary, we conclude that appellants *did* produce sufficient ‘credible evidence’ to support their personal deductions of the real property tax payments” *Id.* (emphasis in original).

The Court of Appeals remanded the case because it found the record insufficient to determine whether the Service had met its burden of proof. *Id.* at 1022. The court added, “[i]t is not sufficient to summarily conclude that the outcome is the same regardless of who bears the burden of proof; if that were the case, § 7491(a) would have no meaning.” *Id.*; *but cf.* *Polack v. Commissioner*, 2004 U.S. App. LEXIS 8612 (8th Cir. 2004) (“The shifting of an evidentiary burden of preponderance is of practical consequence only in the rare event of an evidentiary tie”) (quoting *Cigaran v. Heston*, 159 F.3d 355, 357 (8th Cir. 1998)). On remand, the Tax Court explained that its “statement reflected this Court’s conclusion that Mr. Griffin’s testimony was not only insufficient to support petitioners’ claim to ordinary and necessary business deductions but indeed undermined their claim, insofar as Mr. Griffin’s testimony convinced us that his relevant business activities were conducted entirely through S corporations.” *Griffin II*.

Nonetheless, on remand, the Tax Court ruled for the taxpayer. The court reiterated its view that the record was insufficient to find that the taxpayers were engaged in a trade or business of their own and that it had found no credible evidence supporting the other required element. *See id.* n.5. However, the court seemed to feel trapped by the Court of Appeals’ instructions:

The record before us now is the same as was before us originally and as was before the Court of Appeals. The Court of Appeals has found petitioners’ evidence credible. Whatever adverse inferences we might draw from the evidence (assuming that the opinion of the Court of Appeals does not foreclose our drawing such inferences) are insufficient to overcome petitioners’ evidence, viewed in the light of the degree of credibility that the Court of Appeals has assigned to it.

Id. Yet, the Court of Appeals had contemplated the possibility that the Tax Court would hold for the Service despite the burden of proof shift. *See Griffin*, 315 F.3d at 1022 (“If the same conclusion is reached ... without a new hearing, an explanation is warranted as to how the existing record justifies the conclusion that the Commissioner has met his burden of proof.”).

Unfortunately, although the Court of Appeals held that, “appellants *did* produce sufficient ‘credible evidence’ to support their personal deductions ...,” *id.* at 1021 (emphasis in original), it did not address each element of the legal standard separately. It mentioned evidence with respect to “the factual issue of whether Robert Griffin made the real property tax payments to protect or promote his own real estate and construction

business” *Id.* at 1020. However, it did not directly address the issue of whether the partnerships could not afford to pay the taxes. Although that is probably why the taxpayers paid the taxes, the record apparently was silent on that question. The Court of Appeals also did not address the role of inference, on this issue or any other.

Part of the *Griffin* dilemma therefore seems to be determining what constitutes a “factual issue” for purposes of section 7491. The Service appears to have viewed all of the elements necessary to meet the legal standard as a single “core factual issue.” *See Griffin I.* The Court of Appeals framed “the factual issue [as] whether Robert Griffin made the real property tax payments to protect or promote his own real estate and construction business,”

Griffin, 315 F.3d at 1020, apparently combining requirements (1) and (2)(b) above and ignoring (2)(a). On remand, the Tax Court concluded that “the Court of Appeals found that petitioners had introduced ‘credible evidence’, apparently as to all relevant factual issues” *Griffin II.* If instead, the legal question of deductibility had been viewed as comprising three elements, each requiring different facts, and one of which was not addressed by the evidence, the Service presumably would have won the case.

Thus, it appears that the Court of Appeals did three things that created a problem for the Tax Court and, in turn, the Service. First, it effectively reversed the Tax Court’s credibility determination. Second, in so doing, it apparently did not consider adverse inferences that could be drawn from

the record. Third, it did not analyze each component of the legal issue separately before finding the evidence sufficient to shift the burden of proof. In *Griffin II*, the Tax Court therefore considered only whether the Service had refuted the evidence that the Court of Appeals had found credible. That approach essentially compelled a loss for the Service because it had not produced affirmative contrary evidence; it had focused instead on the meaning of the stipulations of fact, the joint exhibits, and Mr. Griffin’s testimony. The

Tax Court’s about-face in *Griffin II* is more surprising than the Service’s choice to focus on the meaning of the evidence. However, it counsels caution for litigants in future cases; the Tax Court’s actions in *Griffin* provide evidence that the placement of the burden of proof can matter.