April 25, 1985

Award of Attorney's Fees in Tax Cases

Louise L Hill

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HEARING
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SUBCOMMITTEE ON
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justified. These changes in the initial burden of proof should be limited solely to the question of the substantial justification of the government's position on the substantive tax issue involved in determining tax liability. This change would in no way relieve the taxpayer of the burden of proving that he has substantially prevailed, exhausted administrative remedies, and that the amount of the fee claim is reasonable. This shift in the initial burden is limited to only the determination of whether or not the government's position on substantive tax issues was substantially justified. This approach recognizes the distinction between the case-in-chief and the subsequent fee case by a substantially prevailing taxpayer.

I agree that, in the usual case, the taxpayer is in the best position to know the facts relevant to the merits case. However, I can see nothing particularly unique about attorney fee litigation in tax cases that warrants a departure from the EAJA approach.

The instances of "wrong address deficiency notices" may help illustrate why it is sensible to shift the initial burden. The taxpayer in these cases has no way to know why the I.R.S. sent the statutory notice to the wrong address. The taxpayer is simply not in the best position to know the facts. The less the taxpayer knows about how the decision he is challenging is made, the less effective he will be in proving it wrong or unreasonable. This is, of course, usually the critical factor in deciding which party should bear the burden of proof on an issue.

If the I.R.S. can justify its error, it will not be liable for fees. For example, in a situation where the taxpayer withheld information from the I.R.S. that ultimately resulted in litigation (such as not filing a proper change of address), the government may easily prove substantial justification. However, when I.R.S. errors remain unexplained and uncorrected throughout the exhaustion process, and the party must seek, and win, court relief, a procedural rule should not dictate the fee result.

Finally, there has been no evidence that placing the burden of proving substantial justification of the government in EAJA cases has caused problems for government litigators. Neither has the government complained about this burden as a matter of policy in the contest of EAJA legislation. Thus, I urge the Committee to conform the burden of proof in tax cases to that found in the EAJA. To do so will benefit the taxpayer without inconvenience to the government.

Yours very truly,

FRANK S. SWAIN,
Chief Counsel for Advocacy.

Chairman RANGEL. Prof. Louise Hill, University of Toledo College of Law. What is the difference between a college of law and a school of law?

STATEMENT OF LOUISE L. HILL, ASSISTANT PROFESSOR OF LAW, UNIVERSITY OF TOLEDO COLLEGE OF LAW

Ms. HILL. Very little, Your Honor.

Mr. Chairman, as you noted, I am on the faculty of the University of the Toledo College of Law. Up until September of 1983 I was with the Justice Department in the capacity of Assistant U.S. Attorney in the northern district of Ohio. So in terms of my perspective to this matter of fee legislation, I am approaching it from the viewpoint of an academician, as well as an attorney who practiced under this kind of fee award legislation.

I would ask that my statement be included as part of the record. And I would also suggest that rather than reading my statement, I briefly outline some of the major points.

Chairman RANGEL. Without objection.

Ms. HILL. Thank you, sir.

Illustrative of typical proof problems faced by the taxpayer is a former Court of Claims case attempting to define "harassment" by the I.R.S. in Sarkes-Tartarian, Inc. v. United States, 412 F.2d 1201 (Ct. Cl. 1969). The court stated that a prerequisite to determining the existence of harassment was "knowledge as to why the I.R.S. handled the taxpayer as it did." Id. at 1215 (Nichols, J. concurring). The court did not delve deeply into the difficulty or obtaining such knowledge.

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There are certain fundamental differences that have been noted during the proceedings today between TEFRA, which, of course, deals with tax cases and fee awards, and other legislation that deals with general civil litigation, mainly the Equal Access to Justice Act, which was promulgated in 1980.

Directing our attention to those differences in TEFRA there is a maximum ceiling of $25,000, in the Equal Access to Justice Act we don’t see a ceiling, but instead we see an hourly minimum placed on attorneys’ fees of $75 and we also see eligibility requirements, net worth, and size limitations.

As far as prevailing party status is concerned, under TEFRA, as has been noted, the taxpayer must prove the Government’s position was unreasonable and that he substantially prevailed with respect to the amount in controversy, or with respect to the most significant issue or set of issues.

Under the Equal Access to Justice Act, the prevailing party has been interpreted to be a party who succeeds on any significant issue in litigation which achieves some of the benefits the lawsuit sought. That standard, adopted from a first circuit case, has been reiterated by the Supreme Court in Hensley v. Eckerhart, which focused on civil rights attorneys’ fees litigation. That fact notwithstanding the courts in interpreting the Equal Access to Justice Act have relied on the Hensley standard for prevailing party determinations. The fee liability under EAJA is avoided, though, if the U.S. position was substantially justified, and substantial justification in the act’s legislative history indicates we are talking about a standard of reasonableness. While TEFRA addresses unreasonable Government conduct and the EAJA focuses on the reasonableness of the Government’s position, the primary difference is the burden is on the United States under the Equal Access to Justice Act, and is on the taxpayer under TEFRA.

If I might note for a moment the proposed amendments to the Equal Access to Justice Act from 1984, which were passed by Congress, as has been noted, but were vetoed by President Reagan in November 1984.

Congress, under the proposed 1984 amendments to the Equal Access to Justice Act, upped the fee net worth limitations set therein to $2 million for individuals and $7 million for business, from $1 million and $5 million respectively. The prepared amendments also defined the position of the United States, which had been a matter of dispute among the various courts, as an action or omission by the Government which led to the underlying action or civil lawsuit.

During the discussion on the amendments to the Equal Access to Justice Act, at one point the Senate draft of the amendments submitted to the House included provisions which would have amended the fee provision of TEFRA. It was suggested that the maximum be raised to $50,000 and that the taxpayers’ burden of showing Government unreasonableness be eliminated in favor of having the Service show that its administrative actions which gave rise to the issues in the proceeding were substantially justified in order to avoid fee liability. Also to be included was language regarding a showing of special circumstance to avoid fee liability, to make TEFRA more consistent with the Equal Access to Justice Act.
This proposed language was opposed by the House, however, and was deleted from the draft of the amendments which were finally approved by Congress, though, as I noted, vetoed by the President. If you look at the reasons that have been given for a distinction between how attorney's fees in tax cases should be treated versus how fees in general civil litigation should be treated, supposed peculiar problems in tax cases are noted that make tax cases distinct from general civil litigation.

One of the things that has been noted in arguing for a distinction is the heavy case load of the Tax Court. I would suggest, however, that all of the Federal Courts have heavy case loads. And, from the testimony which I have heard this morning, it doesn't appear that the Tax Courts are being terribly adversely affected by the TEFRA fee award legislation.

Another distinction is the fear that court fee awards would discourage taxpayers from using informal special tax court small case procedures, and also would discourage settlements in the Internal Revenue Service regional offices. Regarding this argument, I would say the same could be said for general civil litigation, that in court fee awards could discourage settlements at all of the initial stages of litigation as well as in proceedings at the administrative level.

Another reason given by the Government for why tax cases are distinct from civil litigation is that since tax cases often involve many unrelated issues of fact and several taxable years, often tax cases have no clear cut winner. I would simply note that there are many multi-issue civil cases, and seldom do we see one party prevail on all of the issues raised in a general civil case.

Another point that has been raised in arguing for a distinction is that when we talk about partly net worth and size restraints, such restraints don't serve the same purpose in a tax case as they would in other civil litigation. The Government asserts that such restraints are unnecessary in tax cases since complex and sophisticated issues which are costly to litigate are usually raised by wealthy individuals or corporations.

There also has been an assertion by the Government that asset size is difficult to determine in a tax case. I would simply say that what we seem to be dealing with here is not a rationale for a distinction, but rather a justification for a difference between the awards and for limiting fee awards.

Some other things were raised this morning relating to the distinction between tax cases and civil cases with respect to the burden of proof. The Government, in putting the burden of showing unreasonableness on the taxpayer, is relying on the fact that only the taxpayer knows or has access to facts surrounding the transaction of his private financial transactions.

But I would add that only the Government knows the reason that their position was taken. The Government asserts the position that the burden of proof must be on the taxpayer, from the standpoint of encouraging stipulations of fact during Tax Court litigation in that if it were otherwise it might discourage stipulations of fact. I would say that this, again, could be applicable to all civil cases. Furthermore, we consider the fee issue in a tax case after the substantive issues have been decided, a fact which Commission-
er Egger's colleague referred to, and so the possibility of discouraging stipulations of fact is not a problem.

As far as which position of the Government would be applicable, the Government suggests that we use only the litigation position in that this would then limit the evidence to be considered by the court to matters it has already heard, and it would take up less time.

I would simply say that we have to look to the purpose of this legislation. What we would be saying if we limited the Government's position to its litigation position is, no matter what the conduct of revenue officers or agents initially, there is no fee liability if the minute we get to court we have counsel for the Government taking a reasonable position.

What I would do, Mr. Chairman, is perhaps suggest that we arrive upon some kind of an exhaustion remedy, when we talk about what Government position we should focus on—the litigation position or the prelitigation position. If someone brings a claim and a taxpayer feels that the Government's position is unreasonable, so as not to burden all of the taxpayers of this country, at that moment we would say that the taxpayer involved in the lawsuit would have an obligation to bring this purported unreasonable conduct to the attention of a designated person with the agency. This would give that designated person in the agency an opportunity to correct the purported unreasonable action of the Government official, and at that point, once the agency has had an opportunity to correct the position by someone in authority, we would click in the determination of reasonableness, with respect to evaluating the position of the Government.

That way the taxpayers in general would not be burdened by a mistake by a low-level Government employee, but we would have someone—and I feel, sir, I can say that, having been a Government employee for many years—we would have someone in a responsible position being the one to make the determination to what the Government's substantive position should be.

If we have a situation where the tax case matters are distinctive enough to warrant separate legislation, then separate legislation is appropriate. However, what I don't feel is appropriate is lacing that separate legislation with standards that are more stringent than those which apply to civil litigation in general involving the Federal Government.

I would suggest that the committee determine what threshold qualifications are necessary for a party to be eligible for a fee award from the Federal Government, and to apply those standards uniformly to all parties involved in lawsuits with the Federal Government.

I see nothing wrong with having an exhaustion of administrative remedies requirement, or of excluding declaratory judgments as matters that would be eligible for fee awards in tax cases.

But I would say, sir, that the underlying standards for fee recovery should be applicable to any citizen that is involved in any litigation with the Federal Government.

[The prepared statement follows:]
The Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982 contains provisions for the award of costs and fees to successful litigants in civil tax cases. The cost and fee provisions of TEFRA, however, are more stringent than are the attorneys' fees provisions of the Equal Access to Justice Act (EAJA), which enable qualifying parties to recover fee and cost awards in other civil litigation involving the federal government. It is the position of the Department of the Treasury that due to problems peculiar to tax cases, tax litigation requires specifically tailored legislation for cost and fee awards which is separate and distinct from fee legislation for civil litigation in general. A review of the rationale presented by the Department of the Treasury in support of its claim that distinct fee legislation is necessary in tax cases, however, reveals a purported rationale which is equally applicable to all civil litigation. It may well be that fee awards in tax cases are best dealt with separately from other civil litigation in light of certain procedural and administrative considerations; however, this fact notwithstanding, substantive standards for the recovery of cost and fee awards in tax cases should not vary from those which are applicable to other civil litigation.

Mr. Chairman, members of the subcommittee, in 1982, as part of the Tax Equity and Fiscal Responsibility Act (TEFRA), Congress promulgated provisions for the award of court costs and certain fees in civil tax cases. These provisions, found at 26 U.S.C. § 7430, appeared to be partially in response to the enactment of the Equal Access to Justice Act (EAJA), which permitted prevailing parties to obtain awards of attorneys' fees and other expenses against the United States in certain administrative proceedings and judicial actions. In that the EAJA was interpreted to be applicable to civil tax matters in the United States District Court and the United States Court of Claims (now U.S. Claims Court), but not the United States Tax Court, provisions for costs and fees when included in TEFRA. The effect of the TEFRA fee and cost provisions was to eliminate all tax cases from the purview of the EAJA, presumably with the exception of cases on which fee recovery was based on traditional common law grounds, and to vest all cost and fee matters in tax cases under designated provisions of the Internal Revenue Code. In including a fee and cost provision applicable to all civil tax cases in TEFRA, Congress attempted to prevent forum shopping based on the availability of litigation costs, and acknowledged a purported need to have a cost and fee bill specifically tailored to tax cases.

Under TEFRA, taxpayers who prevail in civil tax actions in which the position of the United States is unreasonable, may be awarded reasonable litigation costs, including attorneys' fees, up to a $25,000 maximum. Whether a taxpayer "prevails" depends upon whether the taxpayer can establish that the government's position was unreasonable, and, whether he substantially prevailed with respect to the amount in controversy or with respect to the most significant issue or set of issues presented. The determination of "prevailing party," as well as the determination of whether the government's position was "unreasonable," is discretionary with the court hearing the case. A determination of what constitutes "reasonable litigation costs" is also made by the court hearing the case. Court costs, expert witness expenses, costs of studies, analyses, reports, tests or projects necessary for case preparation, as well as attorneys' fees or fees incurred by one authorized to practice before the Tax Court, are included in "reasonable litigation costs."

The standard for a cost and fee award in civil actions under the EAJA is different from the enunciated standard under TEFRA. Pursuant to the EAJA (28 U.S.C. § 2412(d)), eligible prevailing parties are entitled to an award of attorneys' fees and other expenses unless the court finds the position of the United States was substantially justified or that a fee award is made unjust by special circumstances. An individual having a net worth of more than one million dollars is not an eligible party under the EAJA; nor is a sole owner of a proprietorship, a partnership, association, corporation or private organization eligible, if its net worth exceeds five million dollars, or if it has more than five hundred employees. As to whether or not a party has prevailed, a party usually may be considered a "prevailing party" if it succeeds on any significant issue in litigation which achieves some of the benefit the lawsuit sought. The "substantial justification" standard is characterized as one of reasonableness, and courts are divided on whether the position of the United States constitutes the government's litigation position or the pre-litigation conduct of the government which was the basis for the underlying civil action. The "special circumstance" provision gives courts discretion to deny awards where equitable consider-
ations would so dictate. Fees under the EAJA are limited to an hourly rate of $75, in the absence of an increase in the cost of living or a special factor which would justify a higher fee. Expenses covered encompass reasonable expert witness costs (up to the rate paid an expert witness by the United States), and reasonable costs of studies, analyses, reports, tests or projects necessary for preparing one's case.

Viewing the cost and fee provisions of TEFRA as compared with those in the EAJA, TEFRA presents a more stringent standard for recovery. For a party to prevail for purposes of a TEFRA fee award, the taxpayer has the burden of establishing that the government's position was unreasonable and that he substantially pre-vailed either with respect to the amount in controversy with respect to the most significant issue or set of issues presented. To be entitled to a fee award under the EAJA, a party must also prevail. However, "prevailing party" status under the EAJA may be more easily achieved by showing that the party has succeeded on any significant issue in the litigation which achieves some of the benefit sought. The government is relieved from liability for fees under the EAJA upon a showing that its position was substantially justified or that special circumstances would make a fee award unjust. While substantial justification has been characterized as a standard of "reasonableness," which is not dissimilar from the "unreasonable" standard for the government's position under TEFRA, the EAJA scheme differs markedly since the burden rests with the United States, and not the challenging party, to meet the burden of proof.

Fee and cost provisions under TEFRA and the EAJA both allow for discretionary action by the court (although more discretion appears to be embodied in the TEFRA provisions), and both statutes consider similar types of expenses to be those which come within the purview of a fee and cost award (although the EAJA limits the expert witness reimbursement to the maximum paid to a government expert and TEFRA allows for fees incurred by lawyers and non-lawyers who are authorized to practice before the Tax Court). A significant difference, however, lies in the amount of the award which is available to prevailing parties under the respective statutes. Under the EAJA, there is no ceiling on the total amount a party may recover, although absent special circumstances, a $75 per hour maximum is attached to fee awards. Under TEFRA, conversely, there is no hourly minimum contained in the statute but a ceiling of $25,000 is put on the overall award. Another distinction between the fee provisions lies in the fact that the EAJA sets party net worth and size limitations for eligibility, which are not found in TEFRA.

In 1984, with a view toward the October 1, 1984 sunset provision of the EAJA, Congress reviewed the implementation of the EAJA and passed certain amendments which would have modified the EAJA and enacted it on a permanent basis. Although the proposed amendments to the EAJA were vetoed by President Reagan on November 8, 1984, they are nevertheless instructive in terms of revealing Congressional intent on federal government liability for fee and cost awards. In proposing amendments to the EAJA, Congress decided to raise the net worth limitation for eligibility to two million dollars for individuals and seven million dollars for business entities. Among other modifications, Congress also clarified that the position of the government which made a fee award is the significant issue in the litigation which achieves some of the benefit sought. The position was substantially justified, in order to avoid liability for an award, absent a finding that special circumstances would make an award unjust. Such proposed amendments to TEFRA were met with stringent opposition in the House of Representatives. The House deleted the TEFRA provisions and thus the final draft of the EAJA amendments which went to the President contained no mention of any modifications to the Internal Revenue Code.

Historically, the Department of the Treasury has been opposed to any bill which would increase fee and cost awards for tax cases within the context of general civil litigation. Reasoning that tax litigation encompasses peculiar problems distinct from civil litigation in general, the Treasury Department lobbied to have tax cases elim-
nated from the content of the EAJA. It was argued that tax cases required narrowly drafted fee and cost award provisions which would balance the twin objectives of not encouraging litigation to the point of disrupting tax collections, while not being restrictive so that a taxpayer would feel incapable of defending his interests. Specific reasons given by the Treasury as to why tax cases should be dealt with apart from other civil litigation were as follows: the heavy caseload of the Tax Court; the fear that the lure of court fee awards would discourage taxpayers from using the informal special Tax Court small case procedure; the fear that the lure of cost and fee awards would discourage settlements in the IRS Regional Office; and that since tax cases often involve many unrelated issues of fact and several taxable years, there is often no clear-cut winner. The Treasury further attempted to distinguish tax cases from general civil litigation by focusing on restraints on net worth and size limitations, versus a provision which would set a maximum award constraint. It was the position of the Department of the Treasury that unlike the typical civil matter, the more complex and sophisticated issues in a tax case, which are costly to litigate, are usually raised by wealthy individuals and corporations. In that the underlying purpose for federal government fee liability is to enable parties to redress wrongs they have suffered at the hand of the United States, and in that there exists a correlation between the amount at issue in a tax case and the taxpayer's ability to pay for litigation, the Department of the Treasury noted that net worth limitations would not serve the same purpose in tax cases as they would for civil litigation in general. Furthermore, the Treasury claimed that determinations of asset size would be difficult to ascertain. Rather the Treasury purported that a ceiling limitation on the dollar amount of awards would be appropriate in tax cases in order not to encourage excessive litigation while assuring relief to taxpayers with limited resources.

A review of the rationale given by the Treasury Department for why tax cases should be treated separately from general civil litigation reveals a relatively weak argument. Each justification presented by the Treasury for separate and unique treatment appears to be equally applicable to all civil litigation. All of the federal courts have heavy case loads and the lure of awards for court costs and fees can be said to discourage settlements in any civil action in the initial stages or at the administrative level. Most civil litigation also contains multi-issues and more often than not, one party does not prevail in every issue of a lawsuit. As to the assertion that net worth limitations fail to further the purpose for cost and fees awards in tax cases, this argument can be couched as one of justification for limiting the government's liability for fee awards rather than one which holds a valid rationale. If wealthy individuals or large corporations are the ones who are involved in most of the expense-laden litigation, then a size and net worth limitation effectively will place the burden of the litigation expense on the taxpayer, while giving smaller entities access to the courts. The argument that asset size is a difficult fact for the court to determine in tax cases is an interesting one, however. In that the determination of asset size may often be an underlying issue in a tax matter, it appears that more often than not, for meeting eligibility requirements, such a provision might work in favor of the government.

In conclusion, if it is felt that the tax case situation is unique and distinctive enough from a procedural perspective to warrant separate legislation, then separate legislation is appropriate. However, what is not appropriate is lacing that separate with standards that are more stringent than those which apply to civil litigation in general. If Congress finds that there should be a ceiling put on fee and cost awards against the government, or that an hourly minimum for fees should be set, then ceilings or hourly minimums should be applicable to all civil cases. If Congress feels that the burden of showing reasonableness to avoid a fee award should rest with the non-governmental party rather than with the United States, then such standard should be applicable to all civil cases.

With the reconsideration of cost and fee awards in TEFRA coming close in time to when probable considerations for review of the reauthorization of the EAJA will occur, Congress has an ideal opportunity to approach these two pieces of legislation with a view toward equalizing the applicable standards of each. It stands that litigant in a tax case should not have a more difficult burden upon him to qualify for costs and fees against the government, or to be limited in the amount of cost or fee awards, than any other party in civil action against the federal government. It is encumbent upon Congress to determine what threshold qualifications are necessary for a party to be eligible for a fee award from the federal government. Upon such a determination, it is encumbent upon Congress to see that those threshold qualifications are applied uniformly to all parties in a civil law suit in which the United States is involved.
Chairman Rangel. Thank you, Professor Hill, for the time and thought that you have given to the requests of the subcommittee. It certainly has been helpful to listen to your views, not only as a professor, but as a former assistant U.S. attorney.

I ask that the record remain open so that other members may be allowed to ask you questions through staff and hopefully you will be able to respond.

Thank you for your contribution.

Ms. Hill. Thank you, sir.

Chairman Rangel. Our last panel, from the National Federation of Independent Business, Sally Douglas, the manager of research, and James Lagos, vice president for issues for Small Business United.

Thank you for your patience. Your testimony will be entered into the record by unanimous consent. You may proceed.

SALLY L. DOUGLAS, MANAGER OF LEGISLATIVE RESEARCH, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Ms. Douglas. Mr. Chairman, I will summarize my remarks. Most of what I have said you have already heard by several witnesses today.

The National Federation of Independent Business has been a long-time supporter of the Equal Access to Justice Act. We are a supporter of fee shifting statutes that would enable private citizens, small business owners or individuals, to recover fees if they prevail in a case on merits against the Federal Government for unwarranted Federal action.

We believe the intent of Congress in passing the TEFRA legislation, section 7430 was quite similar to the underlying provisions of Equal Access.

That is, to restore the right of the private citizen to protect himself against unwarranted Government action and also to provide an incentive to Federal agencies to act more responsibly.

IRS of course is the single agency of the Federal Government that impacts the universe of small businesses. There is therefore inherently a great potential threat of unwarranted action. Past statistics indicate IRS has not always been justified and can by merit of its unique role as the revenue collector of the Federal Government do considerable damage to individuals and businesses alike. It is therefore particularly critical to our membership that this agency exercise prudence and be held accountable for irresponsible, unwarranted action.

The problems with the language that we see in section 7430 that I would like to concentrate on today have already been discussed. One of them has to do with the burden being placed on the taxpayers under section 7430 as opposed to the Equal Access standard of having the burden on the Government. There have been some comments by previous administration witnesses to that effect.

We see the award of attorney's fees as a separate matter from the case in merits. It is here that the burden shifts, for it is IRS that takes action against the individual regardless of who brings the suit. It is IRS that takes the original action that leads to the suit. And it is IRS that best knows why it did what it did.