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## Further Thoughts on Kanter and Ballard

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FURTHER THOUGHTS ON *KANTER* AND *BALLARD*

By Steve R. Johnson

Steve R. Johnson is the E.L. Wiegand Professor at the William S. Boyd School of Law, University of Nevada, Las Vegas. This article arose out of the author's participation in a program on the *Kanter* and *Ballard* cases on October 1, 2004, given by the Court Procedure and Practice Committee of the American Bar Association Section of Taxation. For stimulating perspectives (sometimes agreeing, sometimes disagreeing with his views), the author thanks the program audience and his co-panelists: Joshua Odintz, Michael Saltzman, Leandra Lederman, and Allen Madison. Some of the research in this article was Madison's. Of course, any errors in this article are the author's, not Madison's or anyone else's. The author also thanks his colleagues at the Boyd School of Law for their suggestions and comments.

The Supreme Court is about to hear arguments in these consolidated cases. They involve constitutional and statutory challenges to the Tax Court's application of its Rule 183 in a controversial unreported income and fraud case. The author argues that the decisions of the Tax Court and of three circuit courts rejecting those challenges are correct under the law and are well founded in important policies as to the operation of the courts.

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On December 7, 2004, the Supreme Court will hear oral arguments in the consolidated *Kanter* and *Ballard* cases.<sup>1</sup> The Tax Court had substantially upheld the IRS's determinations of large deficiencies and fraud penalties against several taxpayers.<sup>2</sup> The taxpayers argued in part that the Tax Court's application of its Rule 183 violated both due process and applicable statutes. I disagreed with those arguments then,<sup>3</sup> and I continue to do so now. On appeal, the taxpayers' challenges to Rule 183 were rejected by the Fifth, Seventh, and Eleventh Circuits.<sup>4</sup> The decisions of those circuits are sound and should be affirmed.

Both an affirmative case and a negative case can be made in favor of the decisions. The affirmative case consists of the values that the current regime reflects, values that would be compromised by accepting the taxpayers' arguments. The negative case responds to the constitutional and statutory contentions raised by the taxpayers and others.

This article has five parts. Part I recounts the procedural context and pertinent facts of the cases. Parts II and III develop the affirmative case. Affirming the decisions would support the process values that courts speak through their opinions and it is inappropriate to go behind opinions to examine judges' thought processes or motivations (Part II), and that courts should be able to craft rules that reflect their needs and safeguard their internal deliberative processes (Part III).

Parts IV and V present the negative case. They do not address every point raised by the taxpayers and others but instead focus on particularly instructive parts of the arguments. Part IV considers the due process arguments. It maintains in part that the taxpayers inappropriately

<sup>1</sup>The Supreme Court granted certiorari in these cases at 124 S. Ct. 2065 and 2066 (2004).

<sup>2</sup>*Investment Research Associates Ltd. v. Commissioner*, T.C. Memo. 1999-407, 78 T.C.M. 95, Doc 1999-39247, 1999 TNT 241-4, 241-5 (1999).

<sup>3</sup>Quoted by David Lupi-Sher and Sheryl Stratton, "Tax Bar Divided on Taxpayers' Attempt to Obtain STJ's Report," *Tax Notes*, Feb. 12, 2001, p. 865 at 868-869.

<sup>4</sup>*Estate of Lisle v. Commissioner*, 341 F.3d 364, Doc 2003-17787, 2003 TNT 148-12 (5th Cir. 2003); *Estate of Kanter v. Commissioner*, 337 F.3d 833, Doc 2003-17426, 2003 TNT 144-23 (7th Cir. 2003) (per curiam), rehearing and rehearing en banc denied; *Ballard v. Commissioner*, 321 F.3d 1037, Doc 2003-4416, 2003 TNT 34-19 (11th Cir. 2003), rehearing and rehearing en banc denied 67 Fed. Appx. 590 (2003).

conflate evaluation of witness credibility and the smaller, included notion of evaluation of witness demeanor, and that the taxpayers seek to impose procedural inflexibility that the due process component of the Fifth Amendment has never required and does not require today. Part V considers the statutory arguments and the policy of judicial transparency. It argues that Rule 183 is consistent with existing statutes, and that, if the rule is to be changed, the agent of change should be Congress, not the Supreme Court.

## I. Background

### A. Special Trial Judges

The 19 judges of the Tax Court are appointed by the president with the advice and consent of the Senate, for 15-year terms.<sup>5</sup> In contrast, special trial judges (STJs) are appointed by the chief judge of the Tax Court and have no statutorily mandated tenure.<sup>6</sup> The chief judge may assign several types of cases to STJs: declaratory judgment proceedings, cases involving amounts under \$50,000, collection due process cases, and "any other proceeding which the chief judge may designate."<sup>7</sup>

"[S]ubject to such conditions and review as the [Tax Court] may provide," the STJ is authorized to render the decision for the court in all but the last of the above types of cases.<sup>8</sup> In the last type, the case may be assigned to the STJ for hearing but it must be assigned to a "regular" judge (the judge) for decision.<sup>9</sup> *Kanter, Ballard*, and related cases are of that type.

The roles of the STJ and the judge in cases like ours are set out in Tax Court Rule 183. That rule has undergone evolution. The current version of Rule 183 has been in place since 1984.<sup>10</sup> In pertinent part, it provides that an STJ "shall conduct the trial"<sup>11</sup> and, after the parties have filed their briefs, "shall submit a report, including findings of fact and opinion, to the Chief Judge, and the Chief Judge will assign the case to a judge [for decision]."<sup>12</sup> The judge

may adopt the [STJ's] report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may recommit the report with instructions. Due regard shall be given to the circumstance that the [STJ] had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the [STJ] shall be presumed to be correct.<sup>13</sup>

<sup>5</sup>Section 7443.

<sup>6</sup>Section 7443A.

<sup>7</sup>Section 7443A(b).

<sup>8</sup>Section 7443(c).

<sup>9</sup>The Supreme Court confirmed this reading of the relevant statutes in *Freytag v. Commissioner*, 501 U.S. 868, 873-77 (1991).

<sup>10</sup>See Amendments to Rules of Practice and Procedure of the United States Tax Court, 81 T.C. 1043, 1069 (1983).

<sup>11</sup>Tax Ct. R. 183(a).

<sup>12</sup>*Id.* R. 183(b).

<sup>13</sup>*Id.* R. 183(c).

Before 1984 the rule (then numbered as Rule 182) provided that the STJ would "file" the report (as opposed to "submit" it as under current Rule 183).<sup>14</sup> Under the former rule, the STJ's original report was served on the parties and they were permitted to file exceptions to it.<sup>15</sup> The Tax Court did not explain its reasons for changing the rule. However, the court's comment regarding the new rule did state: "The prior provisions for service of the [STJ's] report on each party and for the filing of exceptions to that report have been deleted."<sup>16</sup>

### B. *Kanter and Ballard*

Burton Kanter was a prominent tax attorney. Claude Ballard and Robert Lisle were vice presidents of Prudential Life Insurance Co. The IRS alleged that Kanter, Ballard, and Lisle participated in a scheme in which persons who sought to do business with Prudential paid kickbacks to Kanter, which were divided among Ballard, Lisle, and Kanter. The IRS further alleged that the three funneled the kickbacks through a complex web of trusts, partnerships, and corporations. The IRS issued notices of deficiency determining, in addition to about 40 other adjustments, that millions of dollars of kickbacks and other income had been improperly omitted from the taxpayers' income tax returns. Later, the IRS asserted civil fraud penalties.

The taxpayers filed Tax Court petitions. The chief judge of the Tax Court assigned the cases for hearing to Special Trial Judge Irvin Couvillion. A lengthy and contentious trial ensued. The trial lasted almost five weeks and produced a transcript exceeding 5,400 pages. The parties' briefs totaled nearly 4,700 pages, and the court "plodded through thousands of exhibits containing hundreds of thousands of pages."<sup>17</sup>

After the trial, the STJ submitted a report on the consolidated cases to the chief judge as required by Tax Court Rule 183(b). The chief judge assigned the cases, again under Rule 183(b), to Judge Howard Dawson for decision. On December 15, 1999, the Tax Court issued its decision. The decision stated: "The Court agrees with the opinion of the Special Trial Judge, which is set forth below."<sup>18</sup> The Tax Court substantially upheld the IRS's determinations. It held that "[a]s a result of the overall scheme, over \$13 million of kickback and other income was omitted by [the taxpayers] collectively."<sup>19</sup> The court also upheld fraud penalties on Lisle, Ballard, and Kanter.

<sup>14</sup>Former Tax Ct. R. 182(b), 60 T.C. 1149 (1973). Federal Rule of Appellate Procedure 10 requires that the record on appeal include "the original papers and exhibits filed in the [trial] court." The Seventh Circuit held that, under the current rule, an STJ's original report is a "preliminary finding[] or report[]" and need not be included in the record on appeal. *Kanter, supra* note 4, 337 F.3d at 842.

<sup>15</sup>Former Rule 182, and so portions surviving in current Rule 183, was "intended . . . to provide procedures more comparable to those which obtain in the Court of Claims." 60 T.C. 1057, 1150 (1976). For discussion of former Rule 182, see *Stone v. Commissioner*, 865 F.2d 342, 344-48 (D.C. Cir. 1989).

<sup>16</sup>81 T.C. at 1070.

<sup>17</sup>1999 TNT 241-4 para. 407.

<sup>18</sup>*Id.* para. 1.

<sup>19</sup>*Id.* para. 646.

There followed rounds of posttrial motions. They focused on the taxpayers' suspicion that the court's opinion came to conclusions more adverse to them than those originally reached by the STJ. Specifically,<sup>20</sup>

- In April 2000 the taxpayers moved for access to "all reports, draft opinions or similar documents, prepared and delivered to the Court pursuant to Rule 183(b)" or, in the alternative, that the Tax Court either certify the issue for interlocutory appeal or make the STJ's original findings part of the record for appeal. On April 26, 2000, Judge Dawson denied the motion. His order stated that, in his decision for the court, he had given "due regard to the fact that [the STJ] evaluated the credibility of the witnesses . . . and treated the findings of fact recommended by the [STJ] as being presumptively correct."<sup>21</sup>
- In May 2001 the taxpayers filed a motion asking that the STJ's original report be placed under seal and made part of the record for appeal. That motion was denied on May 30, 2000.
- In August 2000 the taxpayers filed a motion asking the Tax Court to reconsider its denials of the previous motions or, in the alternative, to grant a new trial. In support of the motion, the taxpayers submitted an affidavit from one of their lawyers. The affidavit stated that the lawyer had been approached by at least two Tax Court judges (not identified in the affidavit),<sup>22</sup> who said that "substantial sections of the opinion were not written by [the STJ], and that those sections containing findings related to the credibility of witnesses and findings related to fraud were wholly contrary to the findings made by [the STJ] in his report."<sup>23</sup> The affidavit also alleged that the court's findings regarding fraud were made by the judge and that what the lawyer had been told by the two judges was confirmed by what he was told by yet a third unidentified judge.<sup>24</sup>

On August 30, 2000, the Tax Court issued an order denying that motion. The order stated that "contrary to the contents of the affidavit, the underlying report adopted by the Tax Court is, in fact, [the STJ's] report." The order was signed by the judge, the STJ, and the chief judge.

- Subsequently, the taxpayers petitioned an appellate court to issue a writ of mandamus directing the Tax Court to provide taxpayers with a copy of the original STJ's report or, in the alternative, to require the Tax Court to provide any changes made by the judge to the STJ's original report. The petition was denied.

There followed the three unsuccessful appeals. The Fifth Circuit affirmed regarding the Rule 183 issues by a

<sup>20</sup>The following history is drawn from *Ballard*, *supra* note 4, 321 F.3d at 1040-41.

<sup>21</sup>*Doc 2001-2950, 2001 TNT 23-31.*

<sup>22</sup>Their identities were disclosed during oral argument before the Seventh Circuit. See *Kanter*, *supra* note 4, 337 F.3d at 875.

<sup>23</sup>*Ballard*, *supra* note 4, 321 F.3d at 1041.

<sup>24</sup>*Id.*

vote of 3-0; the Eleventh Circuit by a 3-0 vote; and the Seventh Circuit by a vote of 2-1. The one was Judge Cudahy, who concurred in part and dissented in part. He agreed with the majority that Rule 183 does not require disclosure of an STJ's original report; Rule 183 does not require the Tax Court to review an STJ's initial findings under a "clearly erroneous" standard; Rule 183 is not violated "by a quasi-collaborative process of revision of an STJ's report"; and no statute requires disclosure of an STJ's original report.<sup>25</sup>

Judge Cudahy also agreed with some of the majority's conclusions regarding due process. He said:

along the full continuum of due process concerns framed by [Supreme Court precedents], there is no per se due process violation when the ultimate finder of fact reviews preliminary findings *de novo*. Therefore, I agree with the majority that the Fifth Amendment does not require that the Tax Court review STJ findings using any particular degree of deference. This means also that there is no constitutional requirement that the Tax Court use an appellate-style review of its STJs' reports. In this respect, the quasi-collaborative model adopted by the Tax Court is permissible.<sup>26</sup>

In the above respects, Judge Cudahy rejected the taxpayers' interpretation of cases that also feature prominently in their briefs and in amici briefs submitted to the Supreme Court, cases such as *Raddatz*,<sup>27</sup> *Universal Camera*,<sup>28</sup> and *Mathews v. Eldridge*.<sup>29</sup> However, Judge Cudahy concluded that appellate review of the Tax Court's findings could not be effective without access to the STJ's initial report. Judge Cudahy dissented on the ground that ineffective review violates due process.<sup>30</sup>

### C. Reactions

*Kanter*, *Ballard*, and *Lisle* have sparked great interest. Many articles have been written on the cases.<sup>31</sup> Although commentators are divided, most of them criticize the

<sup>25</sup>*Id.*, at 877-81 (Cudahy, J., concurring in part and dissenting in part).

<sup>26</sup>*Id.*, at 882.

<sup>27</sup>*United States v. Raddatz*, 447 U.S. 667 (1980).

<sup>28</sup>*Universal Camera Corp. v. NLRB*, 340 U.S. 474 (1951).

<sup>29</sup>424 U.S. 319 (1976).

<sup>30</sup>*Ballard*, *supra* note 4, 337 F.3d at 884-888.

<sup>31</sup>E.g., Randall G. Dick, "Further Thoughts on Tax Court Special Trial Judge Reports," *Tax Notes*, Feb. 26, 2001, p. 1253; Randall G. Dick, "When the Special Trial Judge Who Hears Your Case Does Not Decide It, What Are Your Options — If Any?" 4 *J. Tax Prac. and Proc.* 19 (Dec. 2002/Jan. 2003); Cornish F. Hitchcock, "Public Access to Special Trial Judge Reports," *Tax Notes*, Oct. 15, 2001, p. 403; Gerald Kafka and Jonathan Ackerman, "Fact-Finding in the Tax Court: Access to Special Trial Judge Reports," *Tax Notes*, Apr. 23, 2001, p. 639; Eric Winwood, "The Reclusive Report: The Tax Court Denies Due Process by Not Disclosing Special Trial Judge Reports to Litigants," 2004 *Fed. Cts L. Rev.* 3. Mr. Dick is the attorney who submitted the affidavit describing alleged conversations with initially unidentified Tax Court judges.

decisions. Many *amicus* briefs have been filed with the Supreme Court,<sup>32</sup> again criticizing the decisions.

All of the critics — whether the taxpayers, commentators, or amici — support giving greater prominence to the original STJ's report (assuming there was one that differed from the report adopted as the Tax Court's decision). There are different forms that such greater prominence could take. The continuum, ranging from weakest to strongest form, includes at least these possibilities: adding the original STJ's report to the record furnished the appellate courts, furnishing the original report to the parties during the Tax Court proceeding, furnishing the original report to the parties and permitting them to file objections to it,<sup>33</sup> and according a greater degree of formal deference to the STJ's findings and recommendations, perhaps as high as "clearly erroneous" deference.<sup>34</sup>

## II. Policy of Not Going Behind Judicial Opinions

If the Tax Court's decision in our cases were consistent with the views of the STJ, all or nearly all of the complaints against the decision evanesce. If the Tax Court's words are taken at face value, the decision *is* consistent with the STJ's views. As noted in Part I, the Tax Court's December 15, 1999, decision stated, "The Court agrees with the opinion of the [STJ], which is set forth below," and the court's August 30, 2000, order — which was signed by the STJ, the judge, and the chief judge — stated, "The underlying report adopted by the Tax Court is, in fact, [the STJ's] report."

The taxpayers' position, therefore, requires going behind or beyond the court's words. Doing so, however, would be distinctly undesirable. There is a strong tradition in our legal culture that courts speak through their issued opinions. Numerous times courts have held that the mental processes of judges and administrators cannot be inquired into or be made subject to discovery. The Supreme Court stated in the often cited decision of *Fayerweather v. Rich*: "A judgment is a solemn record. Parties have a right to rely upon it. It should not lightly be disturbed, and ought never to be overthrown or limited by the oral testimony of a judge . . . of what he had in mind at the time of the decision."<sup>35</sup>

The principle of not looking behind juridical acts is familiar from other contexts as well. For instance, "courts will not review the motives of a legislature in enacting a law";<sup>36</sup> the thoughts of jurors and the processes by which

they reach their verdicts typically are beyond scrutiny;<sup>37</sup> "[t]he inner workings of administrative decision making processes are almost never subject to discovery";<sup>38</sup> and a statutory notice of deficiency represents the official determination of the IRS, and courts should not go behind the notice to examine the IRS's thought processes.<sup>39</sup>

Of course, those rules are not infrangible. Exceptions exist in matters of overwhelming public importance, such as invidious prejudice by the decisionmaker(s) against a protected class of persons. But the reluctance of the courts to create those exceptions underscores the importance of the general principle. Moreover, the rule against looking behind judicial decisions is even stronger than the rules against looking behind other juridical acts.<sup>40</sup> As one court stated: "The trial judge's statement of his mental process is so impervious to attack that even if he were to come forward today and declare that his memorandum misstated his reasons for [his decision], we could not consider his explanations."<sup>41</sup>

That being so, the Supreme Court should accord no weight whatsoever to the affidavit, described in Part I.B., from one of the taxpayers' attorneys describing his alleged conversations with several Tax Court judges. On the strength of the principle just quoted, not even a postdecision statement from the STJ or the judge would be admissible to undercut the Tax Court's decision. Surely, then, alleged statements by other judges should not be.

As courts have said in other contexts,<sup>42</sup> the gain in occasional discovery of error that would result from going behind decisions would be outweighed by the harms, such as uncertainty, prolonged contention, and harassment of decisionmakers to explain, modify, or repudiate their decisions.

Reflect for a moment on how an affidavit such as the one here could come about and what could happen in future cases were such affidavits admissible. Tax Court judges are selected from the ranks of private-sector and government tax attorneys, and they often maintain friendships with their former peers. A current judge might try to console a friend who had just lost a Tax Court case. The words of consolation might be infelicitously phrased or be misperceived by their hearer. More perniciously, a judge might use rumor and innuendo to attack another judge's decisions to make life difficult for a rival or disliked colleague on the bench.

<sup>32</sup>*Amicus* briefs have been filed, jointly or separately, by Public Citizen, the ACLU, the National Federation of Independent Business Legal Foundation, Prof. Leandra Lederman, former Sen. David Pryor, and the Lisles.

<sup>33</sup>In effect, this would restore the pre-1984 version of current Rule 183.

<sup>34</sup>For example, the *Kanter* taxpayers argued to the Seventh Circuit "that the STJ's report cannot be rejected by the Tax Court unless [it is] clearly erroneous." *Kanter*, *supra* note 4, 337 F.3d at 840.

<sup>35</sup>195 U.S. 276, 307 (1904); see also *In re Cook*, 49 F.3d 263, 265 (7th Cir. 1995).

<sup>36</sup>*United States v. Crouch*, 566 F.2d 1311, 1316 (5th Cir. 1978) (citing cases).

<sup>37</sup>E.g., *Tanner v. United States*, 483 U.S. 107, 120-121 (1987).

<sup>38</sup>*Goetz v. Crosson*, 41 F.3d 800, 805 (2d Cir. 1994), cert. denied 516 U.S. 821 (1995); see also *United States v. Morgan*, 313 U.S. 409, 422 (1941).

<sup>39</sup>E.g., *Greenberg's Express Inc. v. Commissioner*, 62 T.C. 324, 327-328 (1974).

<sup>40</sup>E.g., *Goetz*, *supra* note 38, 41 F.3d at 805 ("Clearly, the inner workings of decision making by courts are kept in even greater confidence [than are decisional processes of administrative agencies].").

<sup>41</sup>*Crouch*, *supra* note 36, 566 F.2d at 1316.

<sup>42</sup>E.g., *Tanner*, *supra* note 37, 483 U.S. at 120; *McDonald & U.S. Fidelity & Guaranty Co. v. Pless*, 238 U.S. 264, 267-268 (1915) (both cases making this point in the context of jury verdicts).

I have no reason to believe that misplaced sympathy, malice, or any other unworthy motive explains the affidavit here, and I cast no aspersions on either the lawyer who authored the affidavit or his supposed sources. My point only is that those things could happen in future cases were we to repudiate the sound principle against looking behind judicial decisions. That can of worms should remain sealed. The potential for mischief, for disruption of orderly judicial process, is too great.

In summary, complaints about this decision fail if the Tax Court's decision is consonant with the STJ's view of the case. The Tax Court (including the STJ) has affirmed and reaffirmed that the decision is consonant with the STJ's views. There the matter should end. The Supreme Court should use this case to reaffirm the sound principle that what appellate courts review are the decisions of trial courts, not the mental processes behind those decisions.

### III. Deliberative Process

Compared with some other trial courts, the Tax Court is marked by a considerable degree of internal review, consultation, and deliberation. For example, the chief judge reviews judges' reports, and reports may be circulated and discussed as part of a full-court consideration.<sup>43</sup>

Under Rule 183, there also may be consultation and discussion between the STJ assigned to hear a case and the judge assigned to decide it. That will not happen while the STJ is preparing his original report because, under Rule 183(b), that report is submitted to the chief judge before the chief judge assigns the case to a judge for decision. Discussion may occur, however, after the case has been assigned to the judge as he considers, under Rule 183(c), whether to adopt, modify, or reject in whole or in part the STJ's proposed findings and opinion.

Judge Cudahy recognized that possibility and was troubled by it. He feared that, because of unequal status, the judge could overbear the STJ's convictions, causing the STJ to "revise" his opinion to conform to the judge's views.<sup>44</sup> The judge would then "adopt" what was in name, though not in truth, the new STJ's report. Judge Cudahy wrote:

What Kanter alleges happened in the present case, and what commonly occurs in the Tax Court, is that a Tax Court judge takes the STJ's report . . . and works together with the STJ to edit it. From this process emerges a final report that may or may not bear any resemblance to the original report, but that still may be called the STJ's "opinion" (but not the STJ's "report") if the STJ agrees to subscribe to it. This modified report is then "adopted" by the Tax Court judge and filed as the Tax Court "opinion."

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<sup>43</sup>See section 7460(b).

<sup>44</sup>*But cf. Nash v. Bowen*, 869 F.2d 675, 678-681 (2d Cir. 1989), cert. denied 493 U.S. 812 (1989) (rejecting arguments by administrative law judges (ALJ) that review procedures established by the secretary of Health and Human Services compromised the decisional independence of the ALJs in Social Security cases).

I believe that the record supports the notion that the Tax Court engages in a quasi-collaborative process of review of the STJ's report from which a new and frequently different STJ's opinion emerges to be adopted and agreed with by the Tax Court.<sup>45</sup>

I do not know if that description is correct at the level of fact. Assume *arguendo* that it is. I do not find the possibility of collaboration between the judge and the STJ either distressing or sinister. I think it's good. From a collaborative, consultative process, better decisions presumably will emerge. If the judge asks the STJ, "About this part of your opinion, did you consider X? And what about Y and Z?," the resultant intellectual thrusts and parries are more likely to help than to hurt the quality of decisionmaking.<sup>46</sup>

Both the Eleventh Circuit and the Seventh Circuit underlined the importance of the deliberative process value.<sup>47</sup> The Eleventh Circuit said:

While the procedures used in the Tax Court may be unique to that court, there is nothing unusual about judges conferring with one another about cases assigned to them. . . . And, as a result of such conferences, judges sometimes change their original position or thoughts. Whether [the STJ] prepared drafts of his report or subsequently changed his mind entirely is without import insofar as our analysis of the alleged due process violation . . . is concerned. Despite the invitation, this court will simply not interfere with another court's deliberative process.<sup>48</sup>

The Seventh Circuit agreed, saying:

If . . . Rule 183 in fact provides the opportunity for STJs and Tax Court judges to conference regarding the STJ's preliminary findings, then we have every reason to believe that Tax Court judges would duly regard the input of the STJ and that he, in turn, would participate meaningfully in the exchange. Like [other circuits], we too are loath to interfere with another court's deliberative process.<sup>49</sup>

### IV. Due Process

#### A. Generally

An important part of the complaints against Rule 183 is that the relationship it establishes between the hearing magistrate (the STJ) and the deciding magistrate (the

<sup>45</sup>*Kanter, supra* note 4, 337 F.2d at 876 (Cudahy, J., concurring in part and dissenting in part).

<sup>46</sup>For further discussion of the deliberative process value as it bears on *Kanter/Ballard*, see Allen D. Madison, "Revisiting Access to the Tax Court's Deliberative Process," *Tax Notes*, May 10, 2004, p. 749; Allen D. Madison, "Access to the Tax Court's Deliberative Processes," *Tax Notes*, June 25, 2001, p. 2247.

<sup>47</sup>By incorporation, the Fifth Circuit may have done so as well. See *Lisle, supra* note 4, 341 F.3d at 384 (saying, in its due process analysis: "We find the reasoning of the Seventh and Eleventh Circuits direct and persuasive, and adopt it here.")

<sup>48</sup>*Ballard, supra* note 4, 321 F.3d at 1042-1043.

<sup>49</sup>*Kanter, supra* note 4, 337 F.3d at 844.

judge) is unusual, indeed unique, in federal practice.<sup>50</sup> In other contexts — such as a magistrate judge relative to a district court judge or an administrative law judge relative to an agency secretary or commissioner — the report of the hearing officer is, pursuant to statute or rule, given “clearly erroneous” review by the deciding officer or, at least, is included in the record received by the appellate court reviewing the trial tribunal’s decision.<sup>51</sup>

Accept *arguendo* that the relationship created by current Rule 183(b) is unique in federal practice.<sup>52</sup> I do not think that matters. The courts have repeatedly held that due process is a flexible concept, one that depends on context and does not command that all tribunals’ processes be identical.<sup>53</sup> Quite rightly, courts are reluctant to invalidate the rules of other courts. Due process is not so rigid that the procedures of different tribunals must be wrenched or whittled onto a Procrustean bed.

The taxpayers argue to the contrary (at least in part), relying on a line of cases represented most recently by the Supreme Court’s *Oberg* decision.<sup>54</sup> They maintain, under *Oberg*, that “material departure from well-established and traditional judicial procedures creates a presumptive due process violation.”<sup>55</sup> To be sure, there are words in *Oberg* that can be used to support the taxpayers’ contention. But words in a judicial opinion cannot be divorced from context.<sup>56</sup> Understood contextually, *Oberg* does not carry the taxpayers very far.

In *Oberg* the Supreme Court held that due process was violated by a state rule (added to the state constitution by direct vote of the people)<sup>57</sup> that severely limited judicial

review of punitive damage awards by juries. The Supreme Court reasoned that the Constitution imposes substantive limits on the size of punitive damages awards; that judicial review was an important safeguard under the common law against excessive awards; and that the state’s deprivation of that well-established common-law protection violated due process because the state’s remaining procedures afforded insufficient protection against excessive awards.

In context, *Oberg* is readily distinguishable from *Kanter/Ballard*. First, *Oberg*’s core issue — the concern about runaway juries imposing astronomical punitive damages — was significant. Many courts and commentators have given voice to this concern,<sup>58</sup> and *Oberg* clearly was animated by it. The Court said:

Punitive damages pose an acute danger of arbitrary deprivation of property. Jury instructions typically leave the jury with wide discretion in choosing amounts, and the preservation of evidence of a defendant’s net worth creates the potential that juries will use their verdicts to express biases against big businesses, particularly those without strong local presences. Judicial review of the amount awarded was one of the few procedural safeguards against that danger.<sup>59</sup>

Second, *Oberg* reaffirmed that flexibility, not rigidity, characterizes due process analysis. The Court stated: “Of course, not all deviations from established procedures result in constitutional infirmity. As the Court noted in *Hurtado*, to hold all procedural change unconstitutional ‘would be to deny every quality of the law but its age, and to render it incapable of progress or improvement.’”<sup>60</sup> The Court distinguished *Hurtado* by noting that, in that case, “examination by a neutral magistrate provided criminal defendants with nearly the same protection as the abrogated common-law grand jury procedure.”<sup>61</sup>

In cases such as *Kanter* and *Ballard*, a neutral magistrate, the judge, is empowered and directed by statute and rule to render decision on behalf of the Tax Court, subject to the court’s established procedures. *Oberg* invoked legal tradition to require judicial review of jury awards of punitive damages when other controls were nonexistent or weak. It is a stretch to say that *Oberg* establishes a presumption against the constitutionality of a court’s internal review procedures when they differ from other forums’ internal review procedures. The stretch is greater than elasticity will bear given that *Oberg* reaffirmed the constitutional permissibility of procedural variations.

<sup>50</sup>See, e.g., Brief of Amici Curiae Public Citizen Inc., and the American Civil Liberties Union, *Kanter v. Commissioner*, No. 03-1034, at 5-13.

<sup>51</sup>See, e.g., *Kanter*, *supra* note 4, 337 F.3d at 874-875.

<sup>52</sup>At some stages of this litigation, the government has argued that memoranda prepared by a judge’s law clerk are internal deliberative documents privileged against disclosure. Part of the debate in *Kanter/Ballard* involves whether an STJ’s original report is better likened to a law clerk’s memorandum or to a recommended decision penned by a district court magistrate judge or by an ALJ.

<sup>53</sup>E.g., *Morrissey v. Brewer*, 408 U.S. 471, 481 (1972) (“due process is flexible and calls for such procedural protections as the particular situation demands”); *Cafeteria Workers v. McElroy*, 367 U.S. 886, 895 (1961) (“Due Process, unlike some legal rules, is not a technical conception with a fixed context unrelated to time, place and circumstances.”).

<sup>54</sup>*Honda Motor Co. v. Oberg*, 512 U.S. 415 (1994).

<sup>55</sup>Taxpayers’ Brief on the Merits on Petition for Writ of Certiorari, *Ballard v. Commissioner*, No. 03-184, at 44.

<sup>56</sup>“Particularly in dealing with claims under broad provisions of the Constitution, which derive context by an interpretive process of inclusion and exclusion, it is imperative that generalizations, based on and qualified by the concrete situations that gave rise to them, must not be applied out of context in disregard of variant controlling facts.” *Gomillion v. Lightfoot*, 364 U.S. 339, 343-344 (1960); see also *Northern Nat’l Bank v. Porter Township*, 110 U.S. 608, 615 (1884) (noting, quoting prior cases, that it is “a maxim not to be disregarded that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used”).

<sup>57</sup>Courts have struggled with the proper role of judicial review of constitutional referenda and initiatives. See, e.g., Steve

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R. Johnson, “Supermajority Provisions, *Guinn v. Legislature* and a Flawed Constitutional Structure,” 4 *Nev. L.J.* 491, 502-506 and nn. 81, 96 (2004) (citing authorities).

<sup>58</sup>For example, in *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1 (1991), a majority of the justices agreed that the Due Process Clause imposes limits on punitive damages awards.

<sup>59</sup>*Oberg*, *supra* note 54, 512 U.S. at 432.

<sup>60</sup>*Id.* at 430-31 (quoting *Hurtado v. California*, 110 U.S. 516, 529 (1884)).

<sup>61</sup>512 U.S. at 431.

## B. Eldridge Factors

The taxpayers<sup>62</sup> invoke the three-factor analysis offered in *Mathews v. Eldridge*<sup>63</sup> and repeated in *United States v. Raddatz*.<sup>64</sup> Those factors are: the private interest at stake, the risk of an erroneous determination under the procedures in question, and "the public interest and administrative burdens, including costs that the additional procedures would involve."<sup>65</sup> Far from calling it into question, those cases confirm the constitutionality of Rule 183.

Again, context matters. In *Eldridge* a recipient whose Social Security disability benefits had been terminated challenged the termination on due process grounds. The district court and the circuit court agreed with the recipient. The Supreme Court reversed, upholding the constitutionality of Social Security Administration procedures. The Court held that due process does not require an evidentiary hearing before termination of Social Security benefits.

In so doing, the Court distinguished its earlier decision in *Goldberg v. Kelly*,<sup>66</sup> which had found a due process right to an evidentiary hearing before termination of welfare benefits. *Eldridge* is widely and rightly understood as a retrenchment.<sup>67</sup> By limiting *Goldberg*, it put the brakes on an incipient due process revolution that some had thought would sweep through administrative procedure. In that light, the taxpayers' reliance on *Eldridge* is antihistorical and anticontextual. *Eldridge* was a shield meant to protect agency processes from rigid constitutionalization. The taxpayers would convert that case into a sword with which to attack court processes tailored to the particular tribunal's nature and needs.

Even if we view the *Eldridge* formulation abstractly, divorced from its history and context, it still would not suggest due process infirmity in Rule 183. We consider the three *Eldridge* factors below.

**1. Private interest at stake.** Consider this factor in relation to *Raddatz*, a 1980 case that invoked the tripartite *Eldridge* formulation. The defendant had been convicted of violating a federal statute prohibiting receipt of a firearm through interstate commerce by a convicted felon. On appeal, the defendant alleged due process violation. Before trial, the defendant moved to suppress incriminating statements he had made to police officers. The district court referred the motion to a magistrate judge for an evidentiary hearing, after which the court ruled on the motion based on the record developed at the hearing and the magistrate's proposed findings of fact and recommendation.<sup>68</sup>

<sup>62</sup>See Taxpayers' Brief on the Merits on Petition for Writ of Certiorari, *Ballard v. Commissioner*, No. 03-184, at 47-48.

<sup>63</sup>424 U.S. 319 (1976).

<sup>64</sup>447 U.S. 667 (1980).

<sup>65</sup>424 U.S. at 335.

<sup>66</sup>397 U.S. 254 (1970).

<sup>67</sup>See, e.g., William F. Fox Jr., *Understanding Administrative Law* 151-154 (3d. ed. 1997).

<sup>68</sup>These procedures were set out in the Federal Magistrates Act, 28 U.S.C. section 636(b)(1). The act allows the district court to make *de novo* determination as to those portions of the magistrate's report to which a party objects, and it allows the

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The district court accepted the magistrate judge's proposed findings of fact and recommendations, and it denied the suppression motion. The circuit court reversed, holding that the defendant was denied due process because the district court judge failed personally to hear the controverted testimony on the motion to suppress. The Supreme Court reversed the circuit court. The Court held that the district court was not constitutionally required to rehear the testimony to make an independent evaluation of witness demeanor or credibility.<sup>69</sup>

In addressing the first *Eldridge* factor (the private interest at stake), the Supreme Court noted that, as a practical matter, resolution of a suppression motion often determines whether the defendant will be convicted or acquitted. Nonetheless, the Court held, the interests at stake in a suppression hearing are lower than in the criminal trial itself.<sup>70</sup>

The interests at stake in a Tax Court trial — always civil — are lower than those at stake in criminal trials. They also are lower than those at stake in cases like *Goldberg* and *Eldridge*. Receipt of welfare or (perhaps) Social Security payments may be critical to one's economic security, even survival. Although millions of dollars of tax liability were at stake in *Kanter*, *Ballard*, and related cases, those liabilities are unlikely to rise to the level of imperiling the taxpayers' economic survival, especially given the existence of options such as offers in compromise and bankruptcy. Undeniably, the private interests in our cases are important, but they do not rise to the levels of *Goldberg* (where a due process challenge succeeded) or of *Raddatz* and *Eldridge* (where due process challenges failed).

As a postscript, consider another use taxpayers would make of *Raddatz*. The Court remarked in passing: "The issue is not before us, but we assume it is unlikely that a district judge would *reject* a magistrate's proposed findings on credibility when those findings are dispositive and substitute the judge's own appraisal; to do so without seeing and hearing the witness . . . whose credibility is in question could well give rise to serious questions which we do not reach."<sup>71</sup>

That statement does not control our cases. It was *dictum*, as the Court's own words reveal, and questions that are "serious" in a criminal context may be less so in a civil context. Moreover, the predicate condition, that observing the witness generated findings that are "dispositive," is absent in our cases. That is because of the distinction between demeanor and credibility. That distinction is developed in the discussion immediately below.

district court to accept, reject, or modify, in whole or in part, the magistrate judge's findings and recommendations. The act also allows the district court to receive further evidence or to recommit the matter to the magistrate judge with instructions. *Id.*

<sup>69</sup>447 U.S. at 677-680.

<sup>70</sup>*Id.*, at 677-681.

<sup>71</sup>*Id.*, at 681 n.7 (emphasis in original).



2. **Risk of error.** The taxpayers stress that the STJ was the magistrate who heard and saw the witnesses as they testified at trial. Important to their position is a contention along the following lines: "These are fraud cases. The ultimate issue as to fraud involves the taxpayers' state of mind or intention.<sup>72</sup> Thus, it is particularly important to evaluate the credibility of the witnesses, especially the taxpayers. When a taxpayer is on the stand testifying as to what he knew or intended, the court must evaluate the taxpayer's credibility. The magistrate who presided over the trial, who had the opportunity to observe the witnesses as they testified, is uniquely able to make those vital credibility determinations."<sup>73</sup>

There is something to that contention, but much less than critics of the Tax Court's and circuit courts' decisions might wish. That contention conflates demeanor and credibility. Demeanor is the witness's behavior on the stand. Did she make eye contact? Did she squirm or perspire profusely? How long did she pause before answering? What was her tone? The hearing officer is in a better position to assess those things. But demeanor is only one of the many factors that feed into the credibility determination, and often it is not the most important of those factors.

The Supreme Court's decision in *Anderson v. Bessemer City*<sup>74</sup> is significant in that regard. The Court reaffirmed that a trial court's findings of fact are not to be overturned on appeal unless they are clearly erroneous. The Court gave "opportunity to observe the witnesses" as one rationale, but it did not rest the rule simply on that basis. The Court said that deference is required "even when the . . . court's findings do not rest on credibility determinations, but are based instead on physical or documentary evidence or inferences from other facts."<sup>75</sup> The Court expressly rejected lower court decisions that no deference is due when the trial court's findings are not based on credibility judgments. The Court held:

The rationale for deference . . . is not limited to the superiority of the trial judge's position to make determinations on credibility. . . . [F]actors other than demeanor and inflection go into the decision whether or not to believe a witness. Documents or objective evidence may contradict the witness' story; or the story itself may be so internally inconsistent or implausible on its face that a reasonable factfinder would not credit it.<sup>76</sup>

The testimony of even a witness whose demeanor is smooth, polished, and apparently sincere may be found not credible if his story is contradicted by the objective facts and by the relevant documents. The Tax Court's determinations of fraud against Kanter, Ballard, and Lisle

rested overwhelmingly on the objective facts and the documents, not on "trust me; I was there" assessments of demeanor.

The Tax Court's fraud determinations rested on broadly similar rationales for each of the three taxpayers.<sup>77</sup> They included:

(1) Training and experience of the taxpayers. Those have long been recognized as pertinent to the fraud inquiry.<sup>78</sup> Ballard and Lisle were both sophisticated and experienced businessmen. The former had held high executive positions at Prudential and Goldman Sachs; the latter had held high executive positions at Prudential and Travelers. Kanter had been a practicing tax attorney for over 30 years. He had taught tax courses at the University of Chicago Law School, had written and published extensively on tax topics, and was a nationally prominent tax expert.

(2) Consistent and substantial understatements of income. Those conditions are strong evidence of fraud.<sup>79</sup> Each of the taxpayers had unreported income for over a decade, totaling several million dollars for each.

(3) Engaging in complex series of arrangements to conceal the true nature of the income and the identities of those who earned or received it. The taxpayers' arrangements included commingling funds, using sham entities, creating elaborate money flows, and putting money or property in the names of nominees. Those devices are indicative of fraud.<sup>80</sup>

(4) Impeding the IRS's investigation. In varying degrees, the taxpayers withheld relevant documents, destroyed records, tried to put records beyond the reach of the IRS, and made false and misleading statements to IRS agents. Those actions are evidence of fraud.<sup>81</sup>

The Tax Court's opinion mentioned witness credibility only rarely. For instance, it stated: "Kanter's testimony at trial was implausible, unreliable, and sometimes contradictory. We did not find it credible."<sup>82</sup> Again, referring to three witnesses (not Ballard, Kanter, and Lisle), the court said: "The testimony of [the witnesses] is not credible. They performed no services for [one of the sham entities]. The payments to them were from funds Ballard and Lisle earned from the Prudential transactions."<sup>83</sup>

Those occasional credibility assessments do not undermine my argument. The credibility assessments do not appear to depend on demeanor. Their phrasing suggests that the court disbelieved the witnesses because their

<sup>72</sup>E.g., *Switzer v. Commissioner*, 20 T.C. 759, 765 (1953).

<sup>73</sup>For argument along these lines, see, e.g., Taxpayers' Brief on the Merits on Petition for Writ of Certiorari, *Ballard v. Commissioner*, No. 03-184, at 40-41.

<sup>74</sup>470 U.S. 564 (1985).

<sup>75</sup>*Id.*, at 574.

<sup>76</sup>*Id.*, at 574-575.

<sup>77</sup>The summary in the text is drawn from 1999 TNT 241-4 paras. 602-643.

<sup>78</sup>E.g., *Iley v. Commissioner*, 19 T.C. 631, 635 (1952).

<sup>79</sup>E.g., *Marcus v. Commissioner*, 70 T.C. 562, 577 (1978), *aff'd without published opinion* 621 F.2d 439 (5th Cir. 1980).

<sup>80</sup>E.g., *United States v. Peterson*, 338 F.2d 595 (7th Cir. 1964).

<sup>81</sup>E.g., *Estate of Beck v. Commissioner*, 56 T.C. 297 (1971).

<sup>82</sup>1999 TNT 241-4 para. 639.

<sup>83</sup>*Id.* para. 590.

assertions contradicted the established facts and documents, not because of the witnesses' verbal inflections or nonverbal signals. One does not have to hear the witnesses "live" to conclude that their testimony "was implausible, unreliable, and sometimes contradictory." Those conclusions can easily emerge from comparing the transcribed testimony to the facts established by the documents, by stipulation, or otherwise.

Three additional points. First, I realize that I am attacking a cow sacred to some. Many judges and commentators have remarked on the trial magistrate's opportunity to observe the witnesses; some have almost rhapsodized about it.<sup>84</sup> I must confess that I have long suspected that the benefit of that opportunity has been exaggerated.

In my own life, subsequent events have made it painfully clear that I often have believed smooth liars and disbelieved bumbling truth-tellers. I hope that our trial judges have a higher batting average than mine, but I'm not entirely sure they do. A recent report by a psychology professor presented at an American Medical Association conference, although it studied laypersons rather than judges, fortifies my concern. The report found that the "vast majority" of people fail to detect the "flickers of falsehood" of liars. Of 13,000 people tested, "we found 31, who we call wizards, who are usually able to tell whether the person is lying."<sup>85</sup>

Second, the Supreme Court remarked in the *Morgan* case that "the one who decides must hear."<sup>86</sup> But sweeping statements typically require refinement, certainly in an area like due process. *Morgan* involved a Fair Labor Standards Act determination, and the Court did not require that the secretary of labor (who had ultimate responsibility for making the determination) actually preside at the hearing. Recognizing that, subsequent courts have held that the broad *Morgan* language "is used in the artistic sense of requiring certain procedural minima to insure an informed judgment by the one who has [final decisional] responsibility."<sup>87</sup> Those minima were satisfied in our cases because the judge had available to him the voluminous transcript, stipulations, and documentary exhibits as well as the STJ's findings and recommendations.

Third, analogous lines of cases support the constitutionality of Rule 183. There are times when the decision for the Tax Court is rendered by a judge other than the judge who presided over the hearing. That happens

when the presiding judge resigned,<sup>88</sup> retired,<sup>89</sup> or died<sup>90</sup> after the hearing but before decision. It also happens by statute. When the presiding judge submits her report, the chief judge is empowered to direct that the case be reviewed by the full court. When that happens, section 7460(b) prescribes that the presiding judge's report "shall not be a part of the record in [the] case."<sup>91</sup>

Disappointed taxpayers have raised due process challenges to the decisions in many such cases. Those challenges have uniformly been rejected by the courts, including in fraud cases<sup>92</sup> and often in strong language.<sup>93</sup> The cited cases establish that it is not error for a nonpresiding judge to render a decision for the court; the presiding judge's view (if contrary to the deciding judge's view) need not receive "clearly erroneous" deference; and the presiding judge's report need not be included in the record.

One might rejoin that, in section 7460(b) cases, the presiding judge has the chance to write a dissenting opinion, so the appellate court may become aware of that judge's view of the case. However, that opportunity does not exist in the resignation, retirement, and death cases, a fact that does not alter the result.

In summary, demeanor is only a part of the larger issue of credibility. As the Supreme Court taught in *Anderson*, a trial court's factual findings can rest on objective factors independent of witness demeanor and those findings are entitled to deference on appeal even if based on those factors rather than on demeanor. That describes *Kanter*, *Ballard*, and related cases. The Tax Court's findings of fraud were not demeanor-dependent. The objective facts were discernable by the judge from the record, and they were reviewable by the circuit courts from the record.

**3. Burdens from additional procedures.** For the preceding reasons, the benefits from altering Rule 183 would be small, either by commanding additional deference by the judge to the STJ's conclusions or by adding the STJ's original report to the appellate record. There would, though, be costs. Depending on which change were made, there might be a decrease of the Tax Court's efficiency in case disposition.<sup>94</sup> Moreover, according the original STJ's report greater prominence in the trial or

<sup>88</sup>E.g., *Towers v. Commissioner*, 247 F.2d 233, 234 (2d Cir. 1957), cert. denied 355 U.S. 914 (1958).

<sup>89</sup>E.g., *Seaside Improvement Co. v. Commissioner*, 105 F.2d 990 (2d Cir. 1939), cert. denied 308 U.S. 618 (1939).

<sup>90</sup>E.g., *Amoroso v. Commissioner*, 193 F.2d 583, 586 (1st Cir. 1952), cert. denied 343 U.S. 926 (1952).

<sup>91</sup>See, e.g., *Estate of Varian v. Commissioner*, 396 F.2d 753, 754-755 (9th Cir. 1968); *Heim v. Commissioner*, 251 F.2d 44, 47-48 (8th Cir. 1958); *Powell v. Commissioner*, 94 F.2d 483, 486 (1st Cir. 1938).

<sup>92</sup>E.g., *Halle v. Commissioner*, 175 F.2d 500, 503-504 (2d Cir. 1949), cert. denied 338 U.S. 949 (1950).

<sup>93</sup>E.g., *Towers*, supra note 88, 247 F.2d at 234 ("the contention that the petitioners were deprived of procedural due process is utterly without merit").

<sup>94</sup>See Allen D. Madison, "Revisiting Access to the Tax Court's Deliberative Process," *Tax Notes*, May 10, 2004, p. 749 at 751 ("because of the large volume of cases heard using the Rule 183

(Footnote continued on next page.)

<sup>84</sup>See, e.g., *Queen v. Bertrand*, 4 Moo. P.C.N.S. 460, 481, 16 Eng. Rep. 391, 399 (1867).

<sup>85</sup>Prof. Maureen O'Sullivan, quoted in "Truth 'Wizards' Foil Liars," *Las Vegas Review-Journal*, Oct. 15, 2004, p. 7A (Associated Press report). The emphasis on "usually" is mine, to note that even those few, exceptional people sometimes fail in their demeanor evaluations.

<sup>86</sup>*Morgan v. United States*, 298 U.S. 468, 481 (1936).

<sup>87</sup>*Southern Garment Mfrs. Ass'n Inc. v. Fleming*, 122 F.2d 622, 626 (D.C. Cir. 1941); see also *Estate of Varian v. Commissioner*, 396 F.2d 753, 755 (9th Cir. 1968) (the *Morgan* language "means simply that the officer who makes the findings must have considered the evidence or arguments").

appellate process could undercut the affirmative values developed in Parts II and III above. Under sections 7443A, 7459, and 7460, the decision through which the Tax Court speaks is the decision of the judge, not of the STJ. In addition, formalizing or freezing the STJ's report in its original form could inhibit intellectual give-and-take between the STJ and the judge, to the detriment of the court's internal deliberative process.

### C. Effective Appellate Review

As noted in Part I.B., all nine circuit court judges rejected the due process arguments discussed thus far. Judge Cudahy dissented because of a different due process concern: That the absence of the STJ's original report from the record precluded effective judicial review. However, that concern too is misplaced.

At the outset, it is important to understand what the appellate court reviews. What is reviewed is the decision of the Tax Court,<sup>95</sup> and that decision is rendered by the judge, not by the STJ. Congress said that in sections 7443A and 7460, and the Supreme Court confirmed it in *Freytag*.<sup>96</sup> Therefore, the question is not "did the Tax Court's opinion adequately account for the STJ's findings and recommendations?" Instead, the question is "does the Tax Court's opinion, standing on its own, adequately justify the holding(s) the Tax Court reached?"

In those terms, the Tax Court's opinion was reviewable, effectively reviewable, even as to the fraud determinations. As pointed out in Part IV.B.2., those determinations rested on objective facts developed from an abundant trial record. The circuit courts had that record and were fully able to assess whether the Tax Court's factual findings were supported by the record and whether, as a matter of law, those findings formed a sufficient basis for imposition of fraud penalties. That assessment did not have to juggle ambiguities regarding demeanor because demeanor played a minor role at best in the Tax Court's decision.

An appellate court that found either that the Tax Court's findings were unsupported by the record or that the properly found facts did not establish fraud under the law, had the opportunity, indeed the duty, to reverse. It is noteworthy that one of the circuit courts did that in part: The Fifth Circuit affirmed in *Lisle* as to the deficiencies but reversed regarding the fraud penalties.<sup>97</sup>

### V. Statutory Arguments

As our cases worked their way through the judicial process, taxpayers and others argued that the Tax Court's application of Rule 183 is inconsistent with the rule itself, with the Federal Rules of Appellate Procedure, or with

process, imposing on the Tax Court an extra review process could have a serious effect on the caseload of the Tax Court").

<sup>95</sup>See section 7482(a)(the circuit courts have "jurisdiction to review the decision of the Tax Court").

<sup>96</sup>*Freytag v. Commissioner*, 501 U.S. 868, 875 n.3 (1991)(An STJ "has no authority to decide a case" in the category to which our cases belong).

<sup>97</sup>See *Lisle*, *supra* note 4, 341 F.3d at 375-383.

code sections governing the Tax Court.<sup>98</sup> Those arguments failed to find favor with any of the nine circuit court judges. The Rule 183 argument is very much an uphill fight given the settled principle that a court's interpretation of its own rules is accorded "a great deal of deference."<sup>99</sup> The statutory arguments depend, in the main, on misconstruing "decision," "report," and other terms in the sections.<sup>100</sup>

Moreover, arguments for heightened deference to STJ findings exist in uneasy relation to the direction of sections 7443A(c) and 7460(b) that the decision of the Tax Court is rendered by the judge, not the STJ. For instance, assume that "clearly erroneous" deference were accorded to the STJ findings and that, in a particular case, the judge assigned to decide the case had a 51 percent conviction that the STJ's view was wrong. On a *de novo* standard, the judge would reject the STJ's findings. On a "clearly erroneous" standard, though, the judge would have to accept those findings. Because of deference, the STJ's view would prevail. In effect, the STJ would be rendering the decision on behalf of the court despite the statutes' direction that the judge render that decision.

I want to address in greater detail two arguments: those involving section 7482 and the policy of transparency. Those have been advanced by Leandra Lederman<sup>101</sup> as well as others. Prof. Lederman's is an important voice in tax procedure, and her views deserve respectful consideration.

#### A. Section 7482

Section 7482(a) was enacted in 1948. It provides in relevant part that the circuit courts "shall have exclusive jurisdiction to review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district court in civil actions tried without a jury." Prof. Lederman argues: "The Tax Court's current practice of keeping the reports of [STJs] in Rule 183 cases out of the record on appeal violates this statute because it renders the [circuit courts] incapable of reviewing Tax Court decisions 'to the same extent' as bench trials in the district courts."<sup>102</sup>

But statutes must be interpreted in light of their purposes,<sup>103</sup> and section 7482(a) is no exception. Because of the persons appointed to it and its specialized docket, the Tax Court possesses greater tax expertise than any other federal court. Accordingly, the idea sometimes has been voiced that Tax Court decisions should receive

<sup>98</sup>See, e.g., Brief of Amicus Curiae National Federation of Independent Business Legal Foundation, *Ballard v. Commissioner* and *Kanter v. Commissioner*, Nos. 03-184 and 03-1034, at 19-20 (arguments under sections 7459 and 7461).

<sup>99</sup>*Kanter*, *supra* note 4, 337 F.3d at 878 (Cudahy, J., concurring in part and dissenting in part).

<sup>100</sup>See, e.g., *id.* at 842-43.

<sup>101</sup>Brief of Amicus Curiae Prof. Leandra Lederman, *Ballard v. Commissioner* and *Kanter v. Commissioner*, Nos. 03-184 and 03-1034 (hereafter Lederman Brief); Leandra Lederman, "Transparency and Obfuscation in Tax Court Procedure," *Tax Notes*, Mar. 22, 2004, p. 1539 (hereafter Lederman Article).

<sup>102</sup>Lederman Brief, *supra* note 101, at 1-2.

<sup>103</sup>E.g., *Bob Jones Univ. v. United States*, 461 U.S. 574, 586 (1983).

greater deference than those of other tax trial tribunals. The high-water mark of that was the Supreme Court's 1943 *Dobson* decision.<sup>104</sup>

That aspect of *Dobson* provoked strong opposition. It is clear that a main purpose of the 1948 legislation was to overturn that aspect of *Dobson*.<sup>105</sup> Prof. Lederman agrees.<sup>106</sup> Uncertainty clouds much else about the 1948 legislation and Congress's intentions as to it, as is shown by the painstaking work of Prof. David Shores, who has offered the most comprehensive history of the 1948 legislation.<sup>107</sup> Nonetheless, the anti-*Dobson* purpose was clear.

In this respect, section 7482(a) was a command directed to the appellate courts, a command to cease extraordinary deference to the Tax Court. It was not a command to the Tax Court to structure its internal processes (as to STJs or anything else) along any particular lines. The circuit courts were told how to deal with decisions reaching them from the Tax Court. The Tax Court was not told by what processes it is to reach its decisions.

Section 7482(a) should be given effect in terms of its purpose as to the appellate courts. It should not be converted into a device to change a trial court. My argument draws strength from three Supreme Court administrative law decisions in the last decade. In *MCI*,<sup>108</sup> *Brown & Williamson*,<sup>109</sup> and *ATA*,<sup>110</sup> the Court rejected attempts by agencies to change established jurisdiction or rules based on thin statutory language unsupported by demonstrated congressional intent. "Each of these cases stands for the proposition that Congress does not alter the fundamental details of a regulatory scheme in vague or ancillary provisions."<sup>111</sup> Similarly, statutory language directed at appellate courts should not be the basis for backdoor change of a trial court.

## B. Transparency

Many critics of the decisions in our cases complain that Rule 183 is applied in a secretive manner inconsistent with what they perceive to be a general policy of

transparency in court and administrative processes.<sup>112</sup> Judge Cudahy put it this way: "Transparency is the universal practice of agencies and courts employing these decisional practices. The question then becomes, if there are policy reasons that dictate transparency for everyone else, why do these reasons not apply to the Tax Court?"<sup>113</sup>

One is tempted to respond to the question by invoking aspects of the affirmative case described earlier, but there are anterior responses to the transparency argument. First, the question posed by Judge Cudahy is a question for Congress, not for the courts. It would be illegitimate for a court to say, "We can discern no reason why the Tax Court should be different. Therefore, we will order the Tax Court to conform its procedures to the procedures of other courts and of agencies." That would be judicial legislation. The Tax Court is an Article I court, thus a creature of Congress. Transparency is a policy argument. Congress can change Tax Court procedures based on a policy argument. The courts should not. If, contrary to my view, the Supreme Court concludes that Rule 183's application violates the Constitution or present statutes, the Court can and should invalidate that rule. But the Court should not take that action based on a policy argument alone.

Second, viewed through a wider lens, transparency is hardly a universal principle of our courts. Among other examples, initial drafts of Supreme Court and other courts' opinions are not published or disclosed; law clerks' memoranda to their judges and notes between judges are privileged; predecisional communications among officials of agencies are often shielded by the governmental deliberative privilege;<sup>114</sup> and as previously noted, section 7460(b) provides that an initial report by the assigned judge is omitted from the record on appeal in cases subject to full-court review. In short, while love may conquer all, transparency does not, at least not in our judicial process.

Transparency has great "sound bite" appeal. Opposing that rhetoric is like impugning motherhood, apple pie, and the flag. But slogans should not displace sober analysis of institutional roles and structures, and policies are subject to constraints.<sup>115</sup>

## C. Possible Legislative Change

Prof. Lederman discusses the possibility of Congress enacting legislation to alter Rule 183, and she identifies a candidate vehicle for legislation.<sup>116</sup> Efforts along those lines are being attempted although it is too early to assess the prospects for their success.

<sup>104</sup>*Dobson v. Commissioner*, 320 U.S. 489, 498-507 (1943).

<sup>105</sup>For some of the history, see Steve R. Johnson, "The Phoenix and the Perils of the Second Best: Why Heightened Appellate Deference to Tax Court Decisions Is Undesirable," 77 *Or. L. Rev.* 235, 247-253 (1998).

<sup>106</sup>Lederman Brief, *supra* note 101, at 9 (section 7482(a)(1) "was enacted in 1948 to overturn the holding in *Dobson*").

<sup>107</sup>See David F. Shores, "Deferential Review of Tax Court Decisions: *Dobson* Revisited," 49 *Tax Law.* 629 (1996).

<sup>108</sup>*MCI Telecommunications Corp. v. American Telephone & Telegraph Co.*, 512 U.S. 218 (1994) (rejecting a Federal Communications Commission attempt to modify tariff filing by long-distance carriers).

<sup>109</sup>*FDA v. Brown & Williamson Tobacco Co.*, 529 U.S. 120 (2000) (rejecting a Federal Drug Administration attempt to regulate tobacco as a drug).

<sup>110</sup>*Whitman v. American Trucking Ass'n Inc.*, 531 U.S. 457 (2001) (rejecting an Environmental Protection Agency attempt to modify national air quality standards because of implementation costs).

<sup>111</sup>*New York State Bar Ass'n v. FTC*, 276 F. Supp.2d 110, 127 (D.D.C. 2003).

<sup>112</sup>E.g., Lederman Brief, *supra* note 101, at 22-26; Lederman Article, *supra* note 101, at 1542-1544.

<sup>113</sup>*Kanter*, *supra* note 4, 337 F.3d at 874 (Cudahy, J., concurring in part and dissenting in part).

<sup>114</sup>E.g., *United States v. Weber Aircraft Corp.*, 465 U.S. 792, 798-799 (1984).

<sup>115</sup>Cf. Frank Easterbrook, "Statutes' Domains," 50 *U. Chi. L. Rev.* 533, 541 (1983) ("No matter how good the end in view, achievement of that end will have some cost, and at some point the cost will begin to exceed the benefits.").

<sup>116</sup>Lederman Article, *supra* note 101, at 1543-1544.

For reasons explained above, I would far prefer Congress to the Supreme Court as the agent of change of Rule 183, if there is to be change. Indeed, I would welcome (although not necessarily support) a serious legislative effort on those lines. As noted in Part I.A., the Tax Court did not explain the reasons for its rule change in 1983. One could venture a guess based on timing,<sup>117</sup> but speculation is a poor substitute for explanation.

Hearings on proposed legislation would give the Tax Court renewed opportunity to explain why the 1983 change was made and to present its view as to the current importance or lack thereof of Rule 183. That clarification would be constructive. Based on it and other information, Congress could then balance the rule's benefit(s) against transparency and other values. The superiority of those hearings and explanation over the less flexible process of

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<sup>117</sup>The year 1983 was within the period that saw substantial litigation as to the "first era" of tax shelters (as opposed to the current wave of shelters), and the Tax Court used STJs in many shelter cases. The 1983 change may have been made for efficiency, to move shelter and other cases more expeditiously.

litigation is a further reason why change, if any is desirable, should be effected by Congress, not by the Supreme Court.

## VI. Conclusion

At its most basic level, *Kanter/Ballard* is about whether we will take the chief judge, the judge, and the STJ at their word when they say that the court's opinion adopts the STJ's opinion. If we do, the principal objections to the decisions melt. I firmly believe we should take those officials at their word. Ours is an age of suspicion, and "trust no one" is a standard to which the cynical readily repair. But that approach does not provide a sound foundation for judicial administration over the long run.

In any event, the balance of the argument supports the decision of the Tax Court confirmed by decisions of the Fifth, Seventh, and Eleventh Circuits. Affirmative values as to how courts speak and the nature of their deliberative processes support these decisions, and the constitutional and statutory arguments against them have significant shortcomings. If (a big "if") Rule 183 should be changed, Congress, not the Supreme Court, should be the author of the change.