



## The Limits on Taking a Return Position

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### **I. Injunctions Against Preparer Taking a Return Position**

The case of *USA v. Kapp*, (2009 TNT 84-30) decided by the Ninth Circuit Court of Appeals, gives us a look at the application of return standard positions under the law, as the case involves whether a position taken by a CPA on numerous returns had a realistic possibility of success. While that level of support is lower than would currently be required to take a return position without disclosure, the court's analysis is useful as the court concludes his position did not meet that less strenuous standard.

The IRS had received an injunction against the CPA at the District Court, and the CPA in question appealed that ruling to the Ninth Circuit Court of Appeals. While we hope never to be subject to this sort of IRS action, the underlying analysis is the same one we should be using as we analyze whether our positions are supportable under §6694—and includes some examples of what does not count.

### **II. Law Authorizing IRS Action**

The case today is raised under a provision that grants the government the right to obtain an injunction against a tax preparer stopping the preparer from taking certain actions. That provision, §7407, reads as follows:

Sec. 7407 Action to enjoin tax return preparers

(a) Authority to seek injunction

A civil action in the name of the United States to enjoin any person who is a tax return preparer from further engaging in any conduct described in subsection (b) or from further acting as a tax return preparer may be commenced at the request of the Secretary. Any action under this section shall be brought in the District Court of the United States for the district in which the tax preparer resides or has his principal place of business or in which the taxpayer with respect to whose tax return the action is brought resides. The court may exercise its jurisdiction over such action (as provided in section 7402(a)) separate and apart from any other action brought by the United States against such tax preparer or any taxpayer.

(b) Adjudication and decrees

In any action under subsection (a), if the court finds--

(1) that a tax return preparer has--

(A) engaged in any conduct subject to penalty under section 6694 or 6695, or subject to any criminal penalty provided by this title,

(B) misrepresented his eligibility to practice before the Internal Revenue Service, or otherwise misrepresented his experience or education as a tax return preparer,

(C) guaranteed the payment of any tax refund or the allowance of any tax credit, or

(D) engaged in any other fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws, and

(2) that injunctive relief is appropriate to prevent the recurrence of such conduct,

the court may enjoin such person from further engaging in such conduct. If the court finds that a tax return preparer has continually or repeatedly engaged in any conduct described in subparagraphs (A) through (D) of this subsection and that an injunction prohibiting such conduct would not be sufficient to prevent such person's interference with the proper administration of this title, the court may enjoin such person from acting as a tax return preparer.

(c) Bond to stay injunction [Repealed for actions commenced after December 31, 1989.]

Of special interest in §7407(b)(1)(A)'s reference to actions subject to penalty under §6694. That particular provision has gotten a significant amount of attention in the past year due to changes the Congress twice made to that provision. But those changes did not change the fact that the provision continues to be referenced in this section of the IRC, though it expand this provision beyond “income tax return preparers” and “income tax returns” to cover all returns and all return preparers—just as §6694 itself was expanded.

As the second notes, there two things the IRS must show to obtain injunctive relief—first, that the preparer has engaged in one of the four enumerated types of bad conduct and, second, that an injunction is needed to prevent a recurrence of this bad conduct. If these hurdles are met, an injunction can be issued prohibiting the preparer from engaging in the specific conduct.

If the IRS seeks to prevent he person from acting at all as a preparer, there is a higher standard. The Court must find that the preparer continually or repeatedly engaged in such conduct and that merely prohibiting such conduct would not, by itself, be sufficient to prevent the person's “interference with the proper administration” of the IRC.

In today's case, the District Court did not impose the second “death penaty” provision, but rather imposed the more limited prohibition—in this case, prohibiting the CPA from preparing any returns containing a specific position that he had advocated, but which the Tax Court had not ended up agreeing with.

### III. The Mariners' Meals

The case involves, of all things, the deduction available for meals and incidental expenses (M&IE) under Revenue Procedure 90-60 and its successor, as provided for by §274(d) and implemented under Reg. §1.274-5(j)(1). The case involves two types of seafaring employees—those of mariners who work on oceangoing ships that are away from port for long periods of time (referred to in the opinion as “deep sea mariners”) and those that work on tug boats and barges that are not away from port for such extended periods (referred to as “tug and barge mariners”).

Martin Kapp was a CPA that prepared income tax returns, specializing in preparing returns for various individuals in the transportation industry—and specifically individuals in the two classes noted above. The initial matter of interest involved “deep sea mariners, specifically two of Mr. Kapp's clients:

Between approximately January 1997 and February 2006 Kapp prepared tax returns for mariners who lived on vessels in the course of their employment that claimed the mariner's tax deduction. Two of these returns were for Marin Johnson and Jim Westling, who were employed as deep sea mariners during

the tax year in question. Both individuals were provided meals at no cost, but claimed a deduction based on the number of days at sea multiplied by the full meals and incidental expenses ("M&IE") rate.

Mr. Kapp decided that since the ruling provided they didn't have to substantiate the meals, apparently it was OK if they had no actual expense incurred for the meals portion of the "meals and incidentals" allowance. The IRS did not agree, and Mr. Martin and Mr. Westling found themselves under examination and, eventually, in Tax Court. The panel continues:

The Internal Revenue Service ("IRS") disallowed the deductions, and Johnson and Westling filed petitions in the Tax Court. In 2000, the Tax Court held that although the mariners could deduct travel expenses while working away from home, Johnson and Westling could not deduct the full M&IE rate because they had not actually incurred meal expenses. *Johnson v. Comm'r*, 115 T.C. 210, 215 (2000); *Westling v. Comm'r*, 80 T.C.M. (CCH) 373, 373 (2000). They were permitted to deduct the incidental expenses portion of the M&IE rate, however, because the mariners paid for items including personal hygiene supplies and bottled water at the ship's store. *Johnson*, 115 T.C. at 215; *Westling*, 80 T.C.M. (CCH) at 376. After these rulings, the IRS modified its Revenue Procedures and issued two Chief Counsel Advisories which concluded that the taxpayer may not claim the full M&IE rate when only incidental expenses are incurred. See, e.g., Rev. Proc. 2002-63 § 4.05, 2002-2 C.B. 691; I.R.S. Chief Counsel Advisory 200242038 (October 18, 2002), 2002 WL 31341876, at \*13; I.R.S. Chief Counsel Advisory 200343025 (October 24, 2003), 2003 WL 22422671, at \*6.

Note that it wasn't a complete win for either party—the Tax Court decided that a deduction for meals didn't make sense in this case, but there should be some allowance for incidentals. As noted, the IRS adjusted their position to conform with this decision.

However, Mr. Kapp attempted to read the holding in this case very narrowly—and he went public with his position, as the opinion continues:

After the *Johnson* and *Westling* decisions, Kapp wrote several articles in a trade publication, *The Professional Mariner*, discussing potential tax deductions available to mariners. Kapp theorized about the different deductions available to deep sea mariners, and acknowledged that "claiming this additional meal deduction [when meals are provided] is considered double dipping." He asserted that tug and barge mariners were entitled to claim the full M&IE deduction, reduced by the amount of their grocery allowance. Although he temporarily stopped claiming deductions on behalf of deep sea mariners, he continued to file returns claiming the deduction on behalf of his tug and barge mariner clients.

As we'll discover later, that “temporary” cessation of taking this position for deep sea mariners was reversed for less than stellar reasons by Mr. Kapp—but he decided there existed no limits on tug and barge mariners because the taxpayer in *Johnson* was a deep sea mariner. Mr. Kapp seemed to believe that distinction was somehow important and would have changed the holding of the Tax Court, even though these individuals, like the deep sea mariners, did not actually incur meals expense during their time away from home.

The IRS took note of Mr. Kapp's activities, and an investigation into Mr. Kapp was begun, which Mr. Kapp was notified of in November 2003. The Court details the initial results as follows:

In November 2003 the IRS notified Kapp that he was under investigation for conducting a tax shelter promotion. Attorney Dennis Perez represented Kapp. Perez and Kapp met with George Campos, the IRS agent in charge of the investigation, several times in 2004 and 2005. In a March 2005 meeting, the IRS informed Kapp that the mariner's tax deduction was not allowed under the Internal Revenue Code (“I.R.C.”). A memorandum dated April 18, 2005 drafted by an attorney in Perez's firm concluded that little authority supported Kapp's position that either deep sea mariners or tug and barge mariners were entitled to deduct the full M&IE amount, because both types of mariners are typically provided meals by their employer at no cost.<sup>1</sup>

Mr. Kapp's attorney attempted to assure the IRS the practice would be stopped following this exchange—but the IRS didn't take this assurance at face value and continued to move forward.

On May 2, 2005 Perez wrote a letter to Campos detailing Kapp's position on deductions for tug and barge mariners. He followed with a second letter on July 27, 2005 which stated that “although Mr. Kapp does not necessarily agree with the position you articulated for the first time in our meeting last month . . . he has agreed to cease claiming meal deductions as he has done previously.” Campos did not respond to the letters. After completing his investigation, Campos prepared a final report concluding that “Mr. Kapp is instrumental in preparing erroneous returns and incorrectly interpreting the Internal Revenue Code.” The government filed a complaint in April 2006 seeking an injunction that would prevent Kapp from claiming deductions for meals that are provided to an employee without cost.

Well, it turned out during depositions Mr. Kapp admitted that a few months after that assurance was given, he began again claiming the deduction for deep sea mariners—and his reasons were “unique” if nothing else:

<sup>1</sup> The panel noted Mr. Kapp may have been able to assert attorney client and work product privilege for this document, but that his attorney had been produced by his attorney during discovery, eliminating that option. Suffice it to say that document did not put Mr. Kapp in a favorable light.

During the course of the litigation, Kapp was deposed by the government. He stated that he did not routinely ask mariners whether they were provided meals free of charge by their employer before claiming a deduction on their behalf. Additionally, he acknowledged that while he stopped claiming the full M&IE deduction for deep sea mariners after the Johnson decision, he began claiming it again in late 2005 or early 2006 based on purported endorsement of his position by Campos, and because he needed to be more aggressive in claiming deductions to provide negotiating room with the IRS.

He appeared to be admitting to taking the position primarily so he had something to “give up” in an IRS examination, apparently in hopes that the agent would feel compelled to similarly give up some other adjustment.

Both parties argued at the District Court that they should obtain summary judgement for the following reasons:

Both parties moved for summary judgment in February 2007. Kapp asserted that he was entitled to summary judgment because his position regarding the deemed substantiated deductions for mariners was legally correct and taken in good faith. The government argued that an injunction was proper because Kapp continued to claim the mariner's tax deduction even though he knew the deduction was improper.

The District Court sided with the IRS:

In August 2007 the district court granted summary judgment for the government and permanently enjoined Kapp from preparing tax returns that claim a deduction for meals that are provided to mariners without cost. The injunction also required that Kapp provide a list of clients for whom he prepared returns claiming these deductions, post a link to the court's order on his websites, and explain to his clients that the court determined that he had incorrectly advised them about the mariner's tax deduction.

As well, following the issuance of the injunction the Tax Court did finally deal with a case involving tug and barge mariners—and they did not agree with Mr. Kapp:

Subsequent to the judgment enjoining Kapp, the Tax Court published two cases specifically addressing Kapp's position regarding tug and barge mariners. See *Zbylut v. Comm'r*, 95 T.C.M. (CCH) 1172, 1175 (2008); *Balla v. Comm'r*, 95 T.C.M. (CCH) 1090, 1093 (2008). Relying on the Johnson decision, both cases held that tug and barge mariners could not use the regulations that permit deemed substantiated deductions for meals when no expense was incurred by the taxpayer. *Zbylut*, 95 T.C.M. (CCH) at 1175; *Balla*, 95 T.C.M. (CCH) at 1093.

So we now discover, for sure, that deep sea vs. tug and barge wasn't a meaningful

distinction to the Tax Court when handling the issue of a deduction for M&IE per diem for a taxpayer that incurred absolutely no meals expense.

#### IV. The Ninth Circuit Speaks

Given the fact that Mr. Kapp not only was barred from taking such a position on returns, but also had to confess the error of his position to his clients and post the court decision holding such on his website, he was clearly not pleased with this result. So he decided to appeal the holding to the Ninth Circuit Court of Appeals.

The Court outlines the basic M&IE law to start the discussion, since the key question is whether Mr. Kapp's position had sufficient support under the law to allow him to take this position on returns without disclosure.<sup>2</sup>

The Commissioner issued Revenue Procedures which specify the Federal Travel Regulations M&IE rate as the amount that a taxpayer may deduct in lieu of substantiating the actual cost of meals.<sup>4</sup> Rev. Proc. 90-60, §§ 3.02, 4.03, 1990-2 C.B. 651. The Commissioner updates these Revenue Procedures annually, but the relevant provisions have remained substantially the same since 2000. See, e.g., Rev. Proc. 2000-39, 2000-2 C.B. 340; 2001-47, 2001-2 C.B. 332; 2004-60, 2004-2 C.B. 682; 2005-67, 2005-2 C.B. 729. Travel expenses below the threshold M&IE amounts are deemed substantiated and the taxpayer is not required to provide documentation in order to deduct the expense. Rev. Proc. 90-60, § 4.03, 1990-2 C.B. 651.

Additionally, the Federal Travel Regulations provide that the M&IE rate must be adjusted for a meal furnished to the taxpayer (except as provided in § 301-11.17) by deducting the appropriate amount. 41 C.F.R. § 301-11.18. However, "[a] meal provided by a common carrier or a complimentary meal provided by a hotel/motel does not affect your per diem." 41 C.F.R. § 301-11.17. Ships are included within the definition of common carriers. 41 C.F.R. § 301-10.100.

Mr. Kapp obviously was attempting to use the "common carrier" exception (which was written in the Federal Travel Regulations to cover individuals using them as customers) to also yank in employees of the common carrier, even though they were not simply obtaining transportation. As noted, the Tax Court came to the conclusions that the exception for the complementary breakfast at a Hampton Inn didn't stretch far enough to cover employees of the ship—but was Mr. Kapp's reading at the time the IRS went for an injunction so far from plausible to find that a §6694 penalty would have been available, thus also enabling the injunction?

<sup>2</sup> While the Court doesn't say explicitly that the positions were taken without disclosure, the standard used is the one applicable at the time under §6694 for positions taken without disclosure. Had disclosure been made, the test would have been (at that time) whether the position was frivolous.

Today the tests would be whether a nondisclosed position had substantial authority or whether there was a reasonable basis for a disclosed position.

The Ninth Circuit, in beginning to describe the law, seems to get confused by the various applicable tests, eventually equating “realistic possibility”, “reasonable basis” and “substantial authority” in its references. Unfortunately, it's easy to trip over these different rules, but in the end it appears clear the Ninth Circuit was applying the correct (at the time of his case) 1 in 3 test to the position, which would have been for a “realistic possibility of success” on its merits.

The district court enjoined Kapp from preparing tax returns claiming the mariner's tax deduction under I.R.C. § 7407. An injunction is proper under § 7407 if the court finds that the tax preparer has engaged in conduct subject to penalty under § 6694, and an injunction is appropriate to prevent recurrence of the violation. Section 6694 provides that a tax return preparer is subject to penalty if he prepares a return with understated liability due to an unreasonable position not supported by substantial authority. I.R.C. § 6694.

The applicable regulations further define what conduct is subject to penalty under § 6694. The regulations provide that a person has a reasonable basis for his position "if a reasonable and well-informed analysis by a person knowledgeable in tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on the merits . . ." Treas. Reg. § 1.6694-2(b)(1). Additionally, the substantial authority standard is objective, and is not affected by the taxpayer's subjective belief in the correctness of his position. Treas. Reg. § 1.6662-4(d)(3) (i). The government bears the burden of proving each element for enjoining a tax preparer by a preponderance of the evidence. See *United States v. Estate Pres. Servs.*, 202 F.3d 1093, 1102 (9th Cir. 2000).

Thus, the district court properly enjoined Kapp if (1) he prepared a return that understated liability, (2) due to an unreasonable position, i.e., a position that objectively had a less than one in three chance of being sustained on the merits, and (3) an injunction is appropriate to prevent recurrence.

So did his position rise to meet the 1 in 3 standard? The argument in question, as summarized in the opinion, goes as follows:

Kapp argues that mariners do not have to pay or incur meal expenses in order to claim a deduction under the regulations that allow certain expenses to be deemed substantiated without documentation. He notes that meals provided by common carriers are not required to be subtracted from the allowed per diem deduction amount, and that ships are included within the definition of common carriers. C.F.R. § 301-11.17, -10.100. Therefore, he reasons that mariners who are provided meals while on board a ship should be allowed to claim the full M&IE allowance for days at sea, even though no meal expense is incurred. Kapp also creates several complicated hypothetical examples to support his argument that under the § 274 regulations, certain travelers could claim a

deduction for deemed substantiated expenses when no actual costs are incurred.

However, the Ninth Circuit panel holds that the failure to actually pay any expenses is fatal to the deduction under §162, and lectures on the distinction between Code and Regulations.

Kapp's argument is based on a misunderstanding of the regulations that create the deemed substantiated exception. He essentially argues that Executive Branch agency regulations can be manipulated to subvert provisions of the I.R.C. enacted by Congress. The regulations are intended to interpret and assist in the enforcement of the I.R.C., not to undermine it. The I.R.C. gives the Secretary and the Commissioner discretionary authority to issue regulations to ease the burden on taxpayers, who would otherwise have to meet the extensive substantiation requirements of § 274 in order to claim deductions for business related travel. I.R.C. § 274(d); see additionally *Balla*, 95 T.C.M. (CCH) at 1092. The regulations, however, do not eliminate the requirement in § 162 that expenses must be paid or incurred in order to be deducted.'

The Court then goes on to explain the proper application of these regulations:

The regulations reflect the requirements of § 162. In the first section outlining their purpose, the regulations state that they "provide[ ] an optional method for employees and self-employed individuals who pay or incur meal costs to use in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home." Rev. Proc. 90-60, § 1, 1990-2 C.B. 651 (emphasis added). After the *Johnson* decision, the regulations were altered to provide a method for computing the applicable deduction for incidental expenses when no meal costs are paid and incurred. See, e.g., Rev. Proc. 2002-63 § 4.05, 2002-2 C.B. 691.

Therefore, a meal provided by a common carrier need not be deducted from the per diem M&IE rate under 41 C.F.R. § 301-11.17, but a taxpayer cannot take the per diem deduction if he does not incur any meal related expenses. Rev. Proc. 90-60, § 1, 1990-2 C.B. 651. Additionally, Kapp's examples of individuals who may attempt to manipulate the regulations to claim impermissible deductions when they do not incur expenses does not alter the requirement in § 162 that expenses must be paid or incurred in order to be deducted. Because Kapp claimed deductions on behalf of mariners who did not pay or incur meal expenses, he prepared returns that understated liability.

But merely being found wrong in the end isn't enough—if Kapp's position had a realistic possibility of success, even if not actually successful in the end, he still would not be subject to penalty under §6694 or, by extension, application of an injunction under §7407. The Ninth Circuit notes that there are two positions in play here, and considers

separately his positions with regard to deep sea mariners and for tug and barge mariners.

### A. Deep Sea Mariners Position

The Court makes quick work of this position, noting that Kapp's own article conceded the position following the *Johnson* decision:

Kapp's assertion that deep sea mariners were permitted to take the mariners tax deduction is patently unreasonable in light of the ruling in the *Johnson* case. In that case, which arose from conduct nearly identical to the conduct that is the basis of the injunction, the court stated "[w]e do not read the revenue procedures to allow a taxpayer to use the full M&IE rates when he or she incurs only incidental expenses." *Johnson*, 115 T.C. at 227. Kapp unsuccessfully attempts to distinguish *Johnson*, but the clear implication of the holding is that taxpayers may not deduct meal expenses when no such expenses are incurred. *Id.* Kapp acknowledged as much himself in his *The Professional Mariner* articles.

But Kapp claims that Mr. Campos, the IRS Agent in charge of the investigation of Mr. Kapp, had given him the green light to resume claiming this deduction. He argued:

Kapp claims that he recently resumed the practice of taking a deduction on behalf of his deep sea mariner clients based on alleged approval of the position by Campos. In his declaration submitted in opposition to the government's summary judgment motion Kapp stated that:

I had a long meeting with IRS Agent George Campos on August 12, 2005, during which I reviewed my legal position with him in detail . . . . At the end of the meeting, Mr. Campos sort of threw his arm around me and stated 'Now I understand.' Since Mr. Campos at no time during or after the . . . meeting stated that he disagreed with my position, or that my position was frivolous, I interpreted Mr. Campos'[s] statement as an endorsement of my legal position . . .

Apparently, what may have been simple politeness on the part of Mr. Campos and a decision to reserve final judgment on the matter until he had time to review all materials was claimed by Mr. Kapp to clearly indicate, at least to him, that it was OK to resume taking this position even in light of the *Johnson* holding.

However, §6694 and the regulations referred to in interpreting it do not look to IRS investigating agent's statements—and, in any event, the Court didn't find the events, even if taken as literally true, to amount to a green light to go head.

Even accepting the accuracy of Kapp's description of his interaction with Campos, the conduct is not an affirmation of Kapp's position allowing him to claim the deduction on behalf of deep sea mariners, especially in light of the Johnson ruling. Because a well-informed analysis of the issue by a person knowledgeable in tax law would not lead to the conclusion that Kapp's position had at least a one in three chance of being sustained on the merits, his position was unreasonable and not based on substantial authority.

Thus the court concluded his position with regard to deep sea mariners was clearly not justified. However, what about his claim that he should be able to take the position on tug and barge mariners since the *Johnson* case didn't deal with that matter specifically. The court next goes on to look at his justification there.

## B. Tug and Barge Mariners

The Court did not find that the *Johnson* case could truly be distinguished for those who were tug and barge mariners. The mere fact that the case didn't involve them specifically is not relevant if, in fact, the actual decision is arrived at by the Court based upon factors that are the same for both the taxpayer in *Johnson* and this particular class of taxpayers. As the Court holds:

Kapp argues that claiming the mariner's tax deduction for tug and barge mariners was reasonable because *Johnson* applied only to deep sea mariners. He contends that taking the deduction on behalf of tug and barge mariners, who return to port more frequently, presented novel issues. Although the *Johnson* case arose from a slightly different factual situation, the principles of the Tax Court's holding clearly extend to tug and barge mariners. The essence of the court's holding is that individuals may not deduct the full M&IE rate when they do not incur meal expenses. *Johnson*, 115 T.C. at 227. By extension, if tug and barge mariners do not incur meal expenses, they may not take a deduction. The frequency of a mariner's return to port is irrelevant to the holding of the case.

The court's view is that the *Johnson* case as decided applies to any employees who simply do not actually incur any meal expenses. Other differences between *Johnson* and Mr. Kapp's clients simply aren't relevant in the analysis.

The memorandum prepared by Mr. Kapp's attorney that came into evidence was also cited by the court. It noted:

A memorandum prepared by an associate of Kapp's lawyer Perez concluded there was little support for Kapp's position that tug and barge mariners could deduct meal expenses when no cost was incurred. Although Kapp claims that he asked Perez to play "devil's advocate" and draft a memorandum that laid

out the arguments in opposition to his position, the memorandum presents an even-handed examination of the issues and states that "little if any authority relied on by Mr. Kapp supports the position that he takes." After thoroughly analyzing a host of Tax Court cases and IRS publications, the memorandum concludes that although the "analysis does not foreclose the possibility that Mr. Kapp could ultimately be successful on the issue . . . it appears to me that the weight of authority favors the Government on this issue." Shortly after the date of this memorandum, Perez wrote a letter to Campos stating that although Kapp did not agree with the position taken by the IRS, he agreed to stop claiming the deduction.

The finding of "little or no authority" by a person he hired to take a critical look at his position is not a good development for Kapp—especially since it appears he continued to take that position even after being made aware of the results of this analysis. Presumably, having staked out his position very publicly, it would have been rather awkward for Mr. Kapp to have reversed course at this point—so it appears he decided not to.

The court also noted the Tax Court cases decided specifically on point after Mr. Kapp had prepared these returns. They are significant not because Mr. Kapp knew about them (clearly he could not have), but rather because they back up the conclusion of the panel and Mr. Kapp's own expert that the *Johnson* rationale was going to apply to tug and barge mariners.

Additionally, in two rulings issued after the district court entered the injunction against Kapp, the Tax Court rejected the contention that tug and barge mariners were entitled to deduct the full M&IE allowance when no meal costs were incurred. *Zbylut*, 95 T.C.M. (CCH) at 1175; *Balla*, 95 T.C.M. (CCH) at 1093. While we cannot evaluate the reasonableness of Kapp's position in light of these rulings issued after the IRS investigation, it is worth noting that the Tax Court stated that the issues presented were not novel, and relied heavily on the reasoning in *Johnson* to reach its conclusion. *Zbylut*, 95 T.C.M. (CCH) at 1175; *Balla*, 95 T.C.M. (CCH) at 1093.

Thus the panel concludes:

Although there was no precedent at the time Kapp prepared the returns that specifically stated tug and barge mariners may not claim the mariner's tax deduction, a well-informed analysis by a person knowledgeable in tax law would have led to the conclusion that Kapp's position had less than a one in three chance of being sustained on the merits. Therefore, his position was unreasonable and not supported by substantial authority.

## V. But I Acted in Good Faith

Good faith is a defense against the application of a §6694 penalty, and the panel considered that issue, now having decided that his position lacked the necessary level of support and that Mr. Kapp's actions indicated he would be likely to repeat the actions in the future (something that likely didn't help put the court in a good mood when looking at a good faith defense).

Mr. Kapp attempted to claim he made a good faith effort to seek comment on and support for his position. Specifically he claimed he consulted with attorneys in the IRS National Office for comment on his articles. He also contacted a GSA official to confirm the common carrier exception in the per diem regulations. Finally, he claims to have relied on the advice of two separate attorneys in the private sector.

The court found that his reliance on the IRS attorneys and GSA official would not be relevant even if the Court accepted his testimony as the complete truth on this matter. The Court notes:

Although Kapp made efforts to seek comment on and support for his position, his efforts do not allow him to claim the good faith defense. The government employees contacted by Kapp do not qualify as preparers under the regulations, and he was not entitled to rely on their advice. See Treas. Reg. § 301.7701-15(a); 301.7701-15(a)(6) (defining a "preparer" as a person who prepares returns for compensation and specifically excluding IRS employees performing official duties). Even if the government employees qualified as preparers under the regulations, Kapp is not entitled to rely on their advice unless he can demonstrate that they were aware of all the relevant facts. Treas. Reg. § 1.6694-2(d)(5)(ii). The correspondence between the GSA employee and Kapp does not demonstrate that the GSA employee was aware that the taxpayers in question do not pay or incur any meal expenses. Additionally, the IRS attorneys contacted by Kapp informed him that they could not officially comment on his articles, and that there was no procedure to set up a meeting to provide advice specific to his situation.

So he may have omitted one not so minor detail when discussing the issue with GSA official, and the IRS attorneys specifically declined comment on the matter.

The private sector attorneys could have qualified as a preparer and, as well, could have been relied upon if provided with all information—but Mr. Kapp did not demonstrate either to be the case:

Kapp also claims to have relied on the advice of private sector attorneys Stolar and Palmer, but he has failed to show that either attorney qualifies as a preparer. Even assuming that they qualify, Kapp failed to demonstrate that either was aware of all of the relevant facts underlying the returns he filed claiming the mariner's deduction. The record shows that he had general conversations with Palmer about travel regulations and the *Johnson* case, and

that Stolar reviewed and agreed with his *Professional Mariner* articles. General conversations about regulations and cases and review of an article, however, do not demonstrate that either Stolar or Palmer analyzed the relevant facts and advised Kapp that his position was correct. Kapp's counsel during the investigation, the only attorneys who appear to have analyzed his position in light of all the relevant facts, concluded that he was not entitled to claim the deduction.

Again that memorandum comes back to haunt Mr. Kapp.

Mr. Kapp's final defense is one that we run into from time to time, and that some professionals seem to believe is golden—that the position had survived exams previously, resulting in no change audits and, as such, he should be able to use such practical experience to demonstrate good faith compliance. The Court deals with this one very quickly, noting:

Finally, Kapp is not entitled to rely on "no change" determinations made in IRS audits. See I.R.C. § 6110(k)(3) ("a written determination may not be used or cited as precedent"). Therefore, Kapp is not entitled to assert a good faith defense for his violations of § 6694, and the district court did not err in entering the injunction against him under § 7407.

## VI. But the Injunction is Overbroad

Mr. Kapp tried to argue that the injunction was overbroad in its application. He first claims he is now prevented from claiming deductions that other preparers can claim. The panel replies:

The district court's injunction prevents Kapp from preparing returns claiming a tax deduction for meals that are provided to mariners at no cost. The Tax Court's decisions in *Johnson*, *Balla* and *Zbylut*, however, prevent any tax preparer from claiming such a deduction. The injunction does not place Kapp at a unique disadvantage relative to other tax preparers.

Of course, we should note that preparers who competently, properly and legally prepare returns are blocked by those rulings. While there may very well be preparers out there taking contrary positions (ironically, perhaps by reference to the article Mr. Kapp wrote), the court is not going to deny the petition just so that Mr. Kapp can also violate the law.

He also claims it discriminates against his mariner clients by preventing him from taking deductions that can be taken by his other transportation industry clients. The panel again explains that, in fact, the *Johnson* decision would apply to any client that did not actually incur any meals expense:

Additionally, the injunction does not prevent Kapp from claiming deductions for

mariners that he is entitled to claim for other clients. Section 162 requires that all business expenses must be paid or incurred in order to be deducted. The Commissioner has discretionary authority to issue regulations that alter substantiation requirements under § 274. Treas. Reg. § 1.274-5(j)(1). It is possible that some of these regulations, intended to ease the burden on taxpayers, create situations where an unscrupulous taxpayer may claim a deemed substantiated deduction when no expense is actually incurred. The regulations do not, however, eliminate the requirement that expenses must be paid and incurred before they can be deducted. All taxpayers, regardless of occupation, must first pay or incur expenses before they are entitled to take a deduction. I.R.C. § 162.

## **VII. Conclusions**

Mr. Kapp faced issues that most of us end up facing at some point—we may take a position that later is determined to be erroneous when a court specifically rule on the point. He seems to have responded to his by attempting to find any justification to distinguish the case from being applied to any other client of his. While it is important to analyze whether our fact pattern presents distinguishable characteristics from those in the unfavorable decision, we have to continue merely beyond find that the we found a difference. We have to be able to demonstrate, reasonably, why those differences are significant.

If we approach the issue from the standpoint of first deciding on the conclusion that we are going to get enough support for we are going to tend to run into problems like Mr. Kapp did. While we clearly will be aware of the answer that would be more favorable to our client, we still need to attempt to approach the analysis from an unbiased perspective to determine what true support exists for the position.

We don't have to unerringly determine our answer is right (meaning that we eventually prevail in court), but we do have to make our analysis with the proper level of detachment initially as we arrive at our judgment on the various positions available. And we have to be constantly aware of the bias that may be introduced simply from the standpoint that we either may have staked out the position previously, because the new materials came to light, or because we are aware that other practitioners who may either be less skilled or less scrupulous, may be willing to file returns with the position in question.

In this case, it appeared that the preparer was not willing to consider evidence that supported the opposite conclusion from the one he wanted to arrive at. In the end, his approach to doing the research appears to have cost him the ability to argue that he was not unreasonable in taking this position. Had he documented the weighing of both supporting and contrary rulings, as well as taking into account the conclusions of his own counsel's research that came to a contrary conclusion, he might not have faced the injunction and need to “confess” to his clients and potential clients.