IRB 2012-40
October 1, 2012

ACTION ON DECISION

Subject: International Business Machines Corp. v. United States, 343 F.2d 914 (Ct. Cl. 1965), cert. denied, 382 U.S. 1028 (1966)

Issue: Whether I.R.C. § 7805(b)[1] requires the Service to apply an adverse ruling only prospectively if its retroactive application would treat a taxpayer who requested the ruling differently from a taxpayer who received a favorable ruling on the same subject.

Discussion: Taxpayer, one of two companies that manufactured, sold, and leased "larger electronic computing systems," filed a refund suit for excise taxes, claiming disparate treatment related to section 3406(a)(6) of the 1939 Code and section 4191 of the 1954 Code, which placed a 10% excise tax on the sale price of "business machines" sold by the manufacturer. Prior to April 1955, taxpayer and its competitor paid excise taxes on the computer systems they sold. In April 1955, responding to the competitor's request, the Service issued a ruling that determined that two of the competitor's computer systems were not subject to excise taxes. In September 1955, the competitor requested a refund for excise taxes it paid from January 1, 1952 to April 30, 1955, which the Service granted. The Service later revoked the competitor's ruling, but did so prospectively. As a result of the refund and the ruling, taxpayer's competitor avoided paying excise taxes on two of its computer systems from January 1952 through January 1958.

Taxpayer learned of its competitor's ruling, and, in July 1955, requested that the Service issue the same ruling with respect to one of its "identical" computer systems. In July 1955, taxpayer filed a refund claim for the excise taxes it paid from June 1951 through May 1955. The Service responded to taxpayer's ruling request in November 1957, determining that taxpayer's computer system was a taxable business machine. In April 1958, taxpayer filed a second refund claim for June 1955 through January 1958, which was generally the period covered by the competitor's ruling. The Service denied both refund claims, and taxpayer sued for a refund in the United States Court of Claims.

The Court of Claims approached the refund suit by analyzing whether section 7805(b) should prevent disparate treatment by requiring the Service to apply certain rulings prospectively to equalize the treatment between taxpayers in the "same class," irrespective of the rulings' correctness on the merits. The Court of Claims reasoned that, because section 7805(b) provides the Service with discretion to "prescribe the extent, if any, to which any ruling . . . shall be applied without retroactive effect," the Service abuses its discretion when a ruling's retroactive effect causes the inequitable treatment of competitors. The Court of Claims concluded that the Service abused its discretion by applying taxpayer's ruling retroactively because fairness required the Service not to tax the taxpayer for the period its competitor avoided excise taxes.

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[1] References to I.R.C. § 7805(b) are to the 1954 Code. The provisions regarding the retroactivity of rulings under I.R.C. § 7805(b) in the 1954 Code were moved to I.R.C. § 7805(b)(8) by the Taxpayer Bill of Rights 2, Public Law 104-168 (110 Stat. 1452, 1468-69 (1996)). Other references to the I.R.C. are to the 1986 Code, as amended.

The Service's position is that IBM was incorrectly decided. The Service has never agreed with the holding. The government petitioned the United States Supreme Court, albeit unsuccessfully, for a writ of certiorari, plainly stating its disagreement with the holding. The Service also publicly announced its disagreement with the IBM holding. In AOD 1976-414, in re Rue R. Elson Co., Inc. v. United States, it was stated, "With respect to IBM, we believe the Court of Claims erred in ordering refund of taxes legally owed under the excise tax provisions of the Code." The AOD succinctly describes some of the fundamental difficulties with the IBM concept:

> The concept that an error or omission as to one taxpayer should entitle other similarly situated taxpayers to escape tax in order to achieve "equal justice," or avoid "discrimination," would mean that Congress would no longer determine who is liable for tax. Also, those taxpayers who could not employ discovery and other means to find a "similarly situated" taxpayer who had escaped tax would find the entire tax burden unjustly falling on them. Equal treatment is the goal, but this goal is not fostered by compounding error, and by letting the entire tax burden fall on those who are not "similarly situated" while those who are "similarly situated" escape tax.

IBM's vitality as precedent has been substantially eroded by later judicial pronouncements, including by both the original forum that decided it and its successor court. The same year that IBM was decided, two subsequent decisions of the en banc Court of Claims effectively limited the IBM holding to its facts. See Knetsch v. United States, 348 F.2d 932, 940 n.14 (Ct. Cl. 1965) (limiting IBM as "based on the court's evaluation of the particular circumstances in that case"), and Bornstein v. United States, 345 F.2d 558, 564 n.2 (Ct. Cl. 1965) (distinguishing IBM on the basis of "controlling factual differences"). More recently, the Court of Federal Claims held that taxpayers “cannot claim entitlement to a particular tax treatment on the basis of a ruling issued to another taxpayer.” Fla. Power & Light Co. v. United States, 56 Fed. Cl. 328 (2003), aff’d, 375 F.3d 1119 (Fed. Cir. 2004) (rejecting an electric utility’s argument that it could rely on private letter rulings issued to other taxpayers in order to seek refunds of heavy vehicle excise taxes). In affirming Florida Power & Light, the Court of Appeals for the Federal Circuit cited Knetsch and Bornstein, supra, noting that the en banc Court of Claims itself had limited the IBM holding to its facts. The Federal Circuit also hinted that the holding in IBM may have been effectively overruled by the Supreme Court's opinion in Dickman v. Commissioner, 465 U.S. 330, 343 (1984), in which the Court acknowledged the Commissioner's authority to change retroactively an earlier interpretation of the law. 375 F.3d at 1124-25 & n.10. See also Peerless Corp. v. United States, 185 F.3d 922, 929 (8th Cir. 1999), in which the Eighth Circuit concluded that the Supreme Court’s holding in Dickman foreclosed the disparate treatment argument under IBM. In Atchison, Topeka, and Santa Fe Railway Co. v. United States, 61 Fed. Cl. 501, 506-07 (2004), involving a claim of disparate treatment under the Railroad Retirement Tax Act, the Court of Federal Claims again directly acknowledged its reluctance to extend the holding of IBM beyond the unique facts of that case. The court held that for a plaintiff to succeed on an “unequal treatment” argument, it must be considered through the equal protection component of the Fifth Amendment's Due Process Clause, i.e., whether the retroactive application of a change in interpretation of the law bears a rational relation to a legitimate governmental purpose.

In rejecting a disparate treatment argument based on IBM, the Third Circuit in Merck & Co., Inc. v. United States, 652 F.3d 475, 487 (3d Cir. 2011), stated:

> The policy concerns implicated here are obvious. A simple error by the IRS in applying the tax code should not effectively nullify that provision of the code for all other taxpayers, especially as it is not possible for the IRS to pursue every taxpayer who errs in calculating his tax liability. Further, as the IRS is constantly confronted with attempts of ever-increasing sophistication and variety to evade the tax code, it must be permitted to pursue later tax evaders even if it initially fails to detect a scheme which permits evasion. And if taxpayers could routinely challenge tax assessments by pointing to others who had not been compelled to pay under similar circumstances, the IRS would be swamped by collateral litigation of this kind rather than being able to focus on whether the taxpayer actually complied with the law — which is, in the end, the taxpayer's legal obligation.

Accordingly, the Service will not follow IBM in determining whether to apply adverse rulings or revocations of favorable rulings retroactively. In addition, the Service will not follow IBM in determining whether a taxpayer is entitled to a particular tax treatment because of a claim of disparity with respect to an alleged similarly situated taxpayer, whether or not the taxpayers applied for or received rulings on their respective positions.

Recommendation: Nonacquiescence.

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