ACTION ON DECISION

IRB No. 2011-47
November 21, 2011

Subject: Appleton v. Commissioner, No. 10-4522 (3d Cir. June 10, 2011) (unpublished opinion), rev'g, 135 T.C. 461 (2010)

Issue: Whether the Third Circuit erred in holding that the government of the United States Virgin Islands should be permitted to intervene in the Tax Court deficiency proceeding pursuant to Fed. R. Civ. P. 24(b)(2).

Discussion: The Service, by notice of deficiency, determined that the taxpayer in this case was a participant in a transaction described in Notice 2004-45, 2004-2 C.B. 333, "Meritless Filing Position Based on Sections 932(c) and 934(b)." The taxpayer did not file US federal income tax returns with the Service for the tax years at issue. Instead, he filed only territorial income tax returns with the USVI Bureau of Internal Revenue, the USVI's taxing agency, claiming entitlement to the federal gross income exclusion under I.R.C § 932(c)(4), as a resident of the USVI. The Service challenged the taxpayer's reliance on section 932(c)(4), concluding that the taxpayer had gross income for federal income tax purposes and was required to file US federal income tax returns. The taxpayer petitioned the Tax Court, claiming that the three-year period of limitations under section 6501 had expired because the period of limitations period began to run when he filed the income tax returns with the USVI, and that, as a bona fide resident of the USVI, he was only required to file income tax returns with the USVI.

The USVI moved to intervene in the Tax Court proceeding, on both mandatory and permissive grounds, pursuant to Tax Court Rule 1(b) and Fed. R. Civ. P. 24. The USVI argued that the Service's position on the statute of limitations, under section 6501, was damaging to the USVI's Economic Development Program (EDP); and that the USVI was responsible for administering the provisions of section 934. The Tax Court held that the USVI was not entitled to mandatory or permissive intervention.

Fed. R. Civ. P. 24(b) provides for permissive intervention by state or federal governmental officers or agencies upon timely motion when the issue is based on a statute or regulation that is administered by the officer or agency, and such intervention will not unduly delay the proceedings or prejudice the original litigants. In holding that the USVI be allowed to intervene under Rule 24(b), the Third Circuit majority in a nonprecedential opinion states: "The [administration] requirement also appears to be satisfied, as Appleton's tax assessments are based on an income calculation which takes into account credits created pursuant to 26 U.S.C. § 934, under the [USVI's] EDP." This is clearly erroneous. The USVI does not administer any provision of the Internal Revenue Code, including section 934.

The mere fact that Congress, through section 934, authorized the USVI to reduce the territorial income tax of its residents through local legislation, such as the EDP, does not mean that the USVI "administers." The administration of the Internal Revenue Code, including section 934, is the sole responsibility of the Service, and not the USVI, in whole or in part. The Third Circuit has consistently held that the USVI and the Service are separate and distinct taxing authorities: In creating the mirror code, "Congress created a local, locally collectible income tax and the United States and the Virgin Islands are distinct taxing jurisdictions although their income tax

laws arise from an identical statute applicable to each." Dudley v. Commissioner, 258 F.2d 182, 185 (3d Cir. 1958); see also Chase Manhattan Bank v. Govt. of the Virgin Isl., 300 F.3d 320 (3d Cir. 2002), and Danbury, Inc. v. Olive, 820 F.2d 618 (3d Cir. 1987). Moreover, the statute of limitations issue is a matter of federal law which is not affected by the territorial tax incentive under section 934.

The majority also held that the Tax Court erred in rejecting the USVI's attempt to permissibly intervene in the taxpayer's deficiency proceeding because it failed to use the precise phrases "undue delay" and "prejudice" in holding against the USVI. As observed by the dissenting opinion, the Tax Court concluded that intervention by the USVI would result in redundancy, complications, and delay in the Tax Court proceeding, and would result in prejudice to the Service. Noting that the Tax Court permitted the USVI to file an amicus brief, the dissenting opinion concluded properly that not allowing the USVI to intervene was not an abuse of discretion.

The Service will not follow the Third Circuit's nonprecedential opinion in Appleton in any pending or future litigation, including any case appealable to the Third Circuit. See United States ex rel Wilkins v. United Health Care Group, Inc., No. 10-2747, Slip op. at 26, n. 16, 2011 WL 2573380 at *10 n. 16 (3d Cir. 2011) (Third Circuit refused to discuss a nonprecedential Third Circuit opinion analyzed by the district court).

Recommendation: Nonacquiescence.

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