Mercer Law Review

Volume 55
Number 4 *Eleventh Circuit Survey*

Article 12

7-2004

Federal Taxation

Donald R. Bly

Michael H. Plowgian

Follow this and additional works at: https://digitalcommons.law.mercer.edu/jour_mlr

Part of the Taxation-Federal Commons

Recommended Citation

Bly, Donald R. and Plowgian, Michael H. (2004) "Federal Taxation," *Mercer Law Review*: Vol. 55 : No. 4 , Article 12.
Available at: https://digitalcommons.law.mercer.edu/jour_mlr/vol55/iss4/12

This Survey Article is brought to you for free and open access by the Journals at Mercer Law School Digital Commons. It has been accepted for inclusion in Mercer Law Review by an authorized editor of Mercer Law School Digital Commons. For more information, please contact repository@law.mercer.edu.

Federal Taxation

by Donald R. Bly[*]
and Michael H. Plowgian[**]

I. INTRODUCTION

In 2003 the United States Court of Appeals for the Eleventh Circuit published few tax decisions of any importance. In the Circuit's highest profile tax case of 2003, the court vacated a lower court decision that had held section 527(j) of the Internal Revenue Code[1] unconstitutional.[2] In other procedural cases, the court held that Rule 183 of the Tax Court Rules of Practice and Procedure[3] did not raise due process concerns,[4] and, in a case of first impression, ruled that in determining the total revenue lost in cases concerning fraudulent corporate and personal returns, the losses from unreported corporate income and unreported personal income must be aggregated without reducing the personal income for corporate taxes that should have been paid.[5] In the most important substantive tax case of 2003, the court held that bill credits paid by a public utility to refund previously collected amounts were rate reductions and thus did not qualify for special treatment under section 1341.[6]

---

* Associate in the firm of King & Spalding LLP, Atlanta, Georgia. University of Florida (B.S., 1995); University of Chicago (J.D., 1999).

** Associate in the firm of King & Spalding LLP, Atlanta, Georgia. Denison University (B.A., 1999); Tufts University (M.A.L.D., 2003); Harvard University (J.D., 2003).

1. I.R.C. § 527(j) (2000). Unless otherwise noted, all section references are to the Internal Revenue Code of 1986 as amended.
2. Mobile Republican Assembly v. United States, No. 02-16283, 2003 U.S. App. LEXIS 26286, at *1 (11th Cir. Dec. 24, 2003).
3. 26 U.S.C. app. (2000).
4. Ballard v. Comm'r, 321 F.3d 1037, 1038 (11th Cir. 2003).
5. United States v. Patti, 337 F.3d 1317, 1323 (11th Cir. 2003).
6. Fla. Progress Corp. v. Comm'r, 348 F.3d 954, 959 (11th Cir. 2003); I.R.C. § 1341 (2000).

II. CONSTITUTIONALITY OF SECTION 527(J)

In *Mobile Republican Assembly v. United States*,[7] the Eleventh Circuit vacated a controversial lower court decision, which held section 527(j) unconstitutional.[8] Section 527 provides that political organizations organized primarily to accept contributions and to make campaign expenditures (often referred to as "section 527 organizations") are generally exempt from income tax on their fundraising proceeds.[9] In 2000 Congress enacted sections 527(i) and (j), subjecting would-be section 527 organizations to certain disclosure requirements.[10] Section 527(i) requires a section 527 organization to provide the Secretary of Treasury with notice of its section 527 status before taking advantage of the tax exemption.[11] Section 527(j) requires section 527 organizations to file periodic reports detailing the identity of contributors making donations of more than $200 and the purpose and recipient of expenditures greater than $500.[12] Failure to file these reports subjects a section 527 organization to a tax (calculated at the highest corporate rate under section 11) on the amounts to which the failure relates.[13]

Plaintiffs in *Mobile Republican*, six section 527 organizations and one contributor,[14] alleged that sections 527(i) and (j) were unconstitutional as violations of the First, Fifth, and Tenth Amendments to the United States Constitution.[15] After finding that the section 527 organizations had standing, the district court addressed the substantive constitutional issues. As to the First and Fifth Amendment claims, the district court

---

7. No. 02-16283, 2003 U.S. App. LEXIS 26286 (11th Cir. Dec. 24, 2003).

8. *Id.* at *12.

9. I.R.C. § 527 (2000).

10. I.R.C. § 527(i), Pub. L. No. 106-230, § 1(a), 114 Stat. 477 (2000); I.R.C. § 527(j), Pub. L. No. 106-230, § 2(a), 114 Stat. 477 (2000).

11. I.R.C. § 527(i).

12. I.R.C. § 527(j). The requirement to disclose the purpose of the expenditures was added after the district court's decision in this case. *See* Pub. L. No. 107-276, 116 Stat. 1929 (2002). This amendment to section 527(j) did not affect any of the analyses or rulings discussed herein.

13. I.R.C. § 527(j)(1).

14. These six organizations did not technically qualify as section 527 organizations because they had not filed the notice required by section 527(i). Because they otherwise would have qualified and because the district court found the organizations to have suffered the requisite injury at the hands of section 527(j), this Article will refer to these plaintiffs as section 527 organizations.

15. Because the substantive holding of the district court is not relevant to the Eleventh Circuit's decision, it is discussed only briefly here. For a more complete description of the district court's opinion, *see* David A. Brennan, *Federal Taxation*, 54 MERCER L. REV. 1563 (2003).

concluded that although the requirement to disclose contributors did not violate the Constitution, the section 527(j) requirement to disclose the recipients of the organization's expenditures violated both Amendments. In drawing this line between the penalties for failure to disclose contributors and for failure to disclose expenditures, the district court highlighted the "double trouble" feature of section 527(j).[16]

As an illustration of this point, assume that a political organization collected a single $1000 contribution during 2003. In the absence of section 527, the organization would owe a thirty-five percent corporate tax on this amount, or $350. Under this scenario section 527 can be said to confer a $350 subsidy on the organization. Under section 527(j), however, if the organization fails to disclose the contributor, it will incur a tax on that $1000 at the same thirty-five percent corporate rate. Thus, as the district court stated, the penalty imposed for failure to disclose the contributor could be said to represent "the permissible withdrawal of a tax subsidy through a corresponding, offsetting penalty, so that no First Amendment issue is implicated."[17] Assume that the same organization spent the $1000 to influence an election and similarly failed to disclose the recipient and purpose of its expenditure. Section 527(j) would impose an additional $350 penalty for such failure. Thus, in the eyes of the district court, the penalty for failure to disclose expenditures is an exaction that goes beyond a withdrawal of the subsidy provided by section 527, and, as such, is subject to much stricter scrutiny under the First and Fifth Amendments.[18] The district court found the provision did not meet the higher threshold under either Amendment.[19]

In concluding its opinion, the district court found that section 527(j) violated the Tenth Amendment to the extent it required disclosure by organizations operating at the state and local level.[20] The district court reiterated its view of section 527(j) as a penalty in excess of any potential subsidy, one designed primarily to coerce, not to raise revenue.[21] It concluded that section 527(j) unconstitutionally regulates the state and local electoral process.[22]

On appeal the Eleventh Circuit vacated the district court's decision, but not because of its disagreement with the district court's handling of

---

16. *Mobile Republican*, 2003 U.S. App. LEXIS 26286, at *4-*5.

17. Nat'l Fed'n of Republican Assemblies v. United States, 218 F. Supp. 2d 1300, 1322 (S.D. Ala. 2002).

18. *Id.* at 1322-44.

19. *Id.* at 1336, 1343-44.

20. *Id.* at 1344.

21. *Id.* at 1347-48.

22. *Id.* at 1353.

the substantive issues in the case.[23] Rather, the Eleventh Circuit disagreed with the district court's denial of the Government's motion to dismiss for lack of jurisdiction a year earlier.[24] In 2001 the Government argued that plaintiffs' claims were barred by the "Anti-Injunction Act," better known as section 7421(a).[25] Section 7421(a) provides that, with few and rarely relevant exceptions, "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed."[26] In enacting section 7421(a), Congress established a rule of "pay now, sue later," preventing the Internal Revenue Service and courts from dealing with problems inherent in simultaneous jurisdiction.[27] Section 7421(a) is not without its limitations, however.[28] Courts have created a number of exceptions; one of the most notable for these purposes is a requirement that the assessment relate to a "tax" instead of a "penalty."[29] On the Government's motion to dismiss, plaintiffs argued that section 527(j) constituted a penalty excepted from the application of section 7421(a).[30]

Not surprisingly, the district court held that amounts due under section 527(j) constituted a "penalty" for these purposes.[31] Among the significant factors in the district court's analysis were the heading to section 527(j)(1) ("Penalty for failure [to disclose expenditures and contributions]") and the Internal Revenue Service's description of the amount as a "penalty" on Form 8872 (the relevant form for section 527(j) payments).[32] The district court also compared this provision to the Code's most explicit penalty provisions, such as sections 6672, 6675, 6677, 6683, and found the terminology among the provisions nearly

---

23. *Mobile Republican*, 2003 U.S. App. LEXIS 26286, at *12.

24. *Id.* at *5.

25. *Id.* at *4.

26. I.R.C. § 7421 (2000).

27. "The manifest purpose of § 7421(a) is to permit the United States to assess and collect taxes alleged to be due without judicial intervention, and to require that the legal right to the disputed sums be determined in a suit for refund." Enochs v. Williams Packing & Navigation Co., 370 U.S. 1, 7 (1962).

28. *See Williams Packing*, 370 U.S. at 7 (holding that a taxpayer can challenge a tax if shown that, even under the most liberal reading of the law, the government could not possibly prevail and there is no adequate remedy at law); South Carolina v. Regan, 465 U.S. 367, 378 (1984) (holding that a challenge is allowed when no alternative legal means exist).

29. This exception originated in *Lipke v. Lederer*, 259 U.S. 557, 562 (1922).

30. Nat'l Fed'n of Republican Assemblies v. United States, 148 F. Supp. 2d 1273, 1278 (S.D. Ala. 2001).

31. *Id.* at 1283.

32. *Id.* at 1278-79.

identical.[33] Thus, the district court refused to deny itself jurisdiction to hear plaintiffs' claim by reason of the Anti-Injunction Act.[34]

The Eleventh Circuit, though agreeing with the district court's analysis of the statutory framework governing the motion, disagreed completely with its characterization of section 527(j) as a penalty.[35] In the eyes of the Eleventh Circuit, section 527(j) is "part of the overall tax scheme" and thus governed by section 7421(a).[36] The court cited a United States Supreme Court case, *Regan v. Taxation with Representation*,[37] that was squarely on point.[38] The taxpayer in that case was a tax "think-tank" who challenged the Internal Revenue Service's denial of tax-exempt status. The denial followed from the language of the Code, which denies tax-exempt status under section 501(c)(3) to organizations that dedicate a substantial portion of their activities to influencing legislation.[39] The taxpayer argued that this prohibition unconstitutionally limited its free speech rights under the First Amendment and disadvantaged it, as compared to other similar organizations, in violation of the Fifth Amendment.[40] The Supreme Court rejected the organization's claims, finding that section 501(c)(3) was a tax subsidy provided to organizations that were willing to refrain from lobbying, a form of speech that Congress was free not to subsidize.[41]

The Eleventh Circuit noted that the Supreme Court "analyzed the condition within the context of the overall tax scheme, rather than as a separate provision or penalty."[42] Stated differently, the Supreme Court viewed taxable status as the universal baseline.[43] Just as Congress is permitted to provide exceptions from this baseline for certain activities it wants to subsidize, it is also permitted to define the contours and conditions applicable to organizations who volunteer for such exceptions.[44] Viewed in this light, the Eleventh Circuit found it irrelevant that the penalty for failure to disclose expenditures under section 527(j) may result in a higher tax bill for noncomplicit political organizations:

---

33. *Id.* at 1279.
34. *Id.* at 1283.
35. *Mobile Republican*, 2003 U.S. App. LEXIS 26286, at *5.
36. *Id.*
37. 461 U.S. 540 (1983).
38. *Mobile Republican*, 2003 U.S. App. LEXIS 26286, at *6.
39. I.R.C. § 501(c)(3) (2000).
40. *Regan*, 461 U.S. at 540.
41. *Id.* at 550-51.
42. *Mobile Republican*, 2003 U.S. App. LEXIS 26286, at *7.
43. *Id.*
44. *Id.*

> [T]he fact that some self-declared section 527 organizations may later choose to withhold disclosure and, as a result, may pay more in taxes than they would have paid without tax-exempt status does not make the initial decision to register under section 527 any less voluntary. Rather, we consider the statutory scheme as a whole and treat the consequences of violating the conditions of the subsidy as part of the tax framework.[45]

Because the Eleventh Circuit found that penalties imposed by section 527(j) for violations under section 527 were a tax for purposes of section 7421(a), plaintiffs could not seek injunctive relief, and the case was remanded to the district court with instructions to dismiss for lack of jurisdiction.[46] Of course, as the Eleventh Circuit acknowledged, any plaintiff will be able to bring essentially the same suit once it has paid the penalty.[47] However, given the Eleventh Circuit's complete disagreement with the district court's analysis[48] and its reliance on *Regan*,[49] plaintiffs are unlikely to duplicate their success at trial.

III. TAX COURT RULE 183 DOES NOT VIOLATE DUE PROCESS

In *Ballard v. Commissioner*,[50] the Eleventh Circuit held that the Tax Court's refusal to provide the petitioner with a copy of the original draft of the special trial judge's report did not constitute a denial of the petitioner's due process rights.[51]

According to the Internal Revenue Service, Claude M. Ballard and Robert W. Lisle received kickbacks over the course of several years in return for their influence in approving projects in which Prudential Life Insurance Company would invest. Ballard did not report any of these payments as income; thus, the Internal Revenue Service sent Ballard Notices of Deficiency alleging that he owed additional taxes. Ballard filed a petition for redetermination of the deficiencies in the Tax Court.[52]

Pursuant to Rule 183 of the Tax Court Rules of Practice and Procedure ("Rule 183"),[53] the Chief Judge of the Tax Court assigned the case to Special Trial Judge D. Irwin Couvillion for trial. Special Trial Judge

---

45. *Id.* at *8.
46. *Id.* at *12.
47. *Id.* at *9.
48. *Id.* at *5, *6.
49. *Id.* at *6-*8.
50. 321 F.3d 1037 (11th Cir. 2003).
51. *Id.* at 1043.
52. *Id.* at 1039-40.
53. 26 U.S.C. app. (2000).

Couvillion, in accordance with Rule 183(b), prepared and submitted a written report of his findings of fact and opinions for review by Tax Court Judge H.A. Dawson, Jr. In an opinion issued on December 15, 1999, Judge Dawson adopted the special trial judge's report and provided the parties with the final report. On July 24, 2001, Judge Dawson entered the final order of the Tax Court against Ballard, assessing tax deficiencies of $1,318,648, including penalties.[54]

On April 20, 2000, Ballard, apparently believing that the report adopted by the Tax Court was not the original report prepared by Special Trial Judge Couvillion, filed a motion requesting: (i) access to all reports, draft opinions, or other documents prepared pursuant to Rule 183(b); (ii) certification of the request for such documents for interlocutory appeal; or (iii) incorporation of the initial findings of the special trial judge into the record for appeal to the circuit court. On April 26, 2000, Judge Dawson denied the order.[55] In denying the motion, Judge Dawson, quoting Rule 183(b), noted that he "gave due regard to the fact that Special Trial Judge Couvillion evaluated the credibility of witnesses . . . and treated the findings of fact recommended by the Special Trial Judge as being presumptively correct."[56]

On August 22, 2000, Ballard filed a motion requesting that the Tax Court reconsider its denial of access to the special trial judge's original report, or, alternatively, that the Tax Court grant petitioners a new trial. In support of this motion, Ballard included an affidavit from Randall G. Dick, an attorney for another participant allegedly involved in the kickback scheme. In his affidavit Dick stated that two unidentified Tax Court judges told him that in the original report, the special trial judge concluded that the payments made to Ballard were not taxable and that the fraud penalty was not applicable. Additionally, Dick's affidavit indicated that the two Tax Court judges told him the sections of the Tax Court's opinion regarding the credibility of the witnesses and the findings of fraud were wholly contrary to the findings made by the special trial judge in his report. Finally, Dick stated in his affidavit that he confirmed the allegations of the two Tax Court judges with a third Tax Court judge who indicated that the special trial judge's report had been changed. On August 30, 2000, the Tax Court issued an order signed by Special Trial Judge Couvillion, Judge Dawson, and the Chief

---

54. *Ballard*, 321 F.3d at 1040.

55. *Id.* at 1040-41.

56. *Id.* at 1041. Rule 183(c) provides in part, "Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct." 26 U.S.C. app. (2000).

Judge of the Tax Court, denying the motion and confirming that, contrary to Dick's affidavit, the underlying report adopted by the Tax Court was Special Trial Judge Couvillion's report. Ballard petitioned the Eleventh Circuit for a writ of mandamus seeking an order directing the Tax Court to provide him with a copy of the original report or requiring the Tax Court to provide a description of any changes made by Judge Dawson to the original report. The petition was denied on October 23, 2000.[57]

On appeal Ballard argued that the refusal to release the original draft of the special trial judge's report violated his due process rights. Ballard raised two primary arguments. His first argument was that because the special trial judge was the only judicial official to hear the evidence, the Tax Court should not be permitted to reach conclusions contrary to those of the special trial judge without rehearing the evidence. Ballard's second argument was that if the special trial judge's report was not included in the record, there could be no meaningful review of the Tax Court's actions. Ballard's arguments were thus premised on the assertion that the report adopted and issued by the Tax Court was not Special Trial Judge Couvillion's report;[58] the Eleventh Circuit agreed that had this assertion been correct, serious due process concerns may have been raised.[59]

The Eleventh Circuit rejected this assertion, however, and held that the underlying report adopted by the Tax Court was, in fact, Special Trial Judge Couvillion's report.[60] Thus, the Tax Court did not reach a conclusion contrary to the report of the special trial judge, and the special trial judge's report was included in the record, allowing meaningful review of the Tax Court's decision.[61] The Eleventh Circuit based this finding on the order of August 30, 2000, signed by Special Trial Judge Couvillion, Judge Dawson, and the Chief Judge of the Tax Court, stating that the report adopted by the Tax Court was Special Trial Judge Couvillion's report.[62]

The Eleventh Circuit also concluded that Dick's affidavit did not, in itself, raise due process concerns.[63] Rather, the Eleventh Circuit reasoned that the deliberative process of most courts involves conferences among the judges, and as a result of these conferences, judges may

57. 321 F.3d at 1041.
58. *Id.* at 1042.
59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.* at 1043.
63. *Id.* at 1042.

change their original positions.[64] That Special Trial Judge Couvillion's report may reflect changes from an earlier draft does not raise due process concerns.[65]

The Eleventh Circuit also addressed whether the evidence was sufficient to support a finding of fraud.[66] The court held that the record, including evidence of specific transactions in which the flow of money could be traced to Ballard, supported the conclusion that Ballard participated in the scheme to sell his influence and that he fraudulently failed to report income he received from the scheme.[67] Therefore, the Tax Court did not clearly err in its finding of fraud, and the Eleventh Circuit upheld the penalties.[68]

IV. REVENUE LOSSES FROM FRAUDULENT CORPORATE AND PERSONAL RETURNS MUST BE AGGREGATED TO DETERMINE LOSS UNDER SENTENCING GUIDELINES

In *United States v. Patti*,[69] the Eleventh Circuit ruled on a case concerning both a fraudulent corporate income tax return and a fraudulent personal income tax return.[70] The court held that the aggregate loss for purposes of determining the offense level under the federal sentencing guidelines should include the tax revenue lost because of the fraudulently unreported corporate income and the revenue lost because of the fraudulently unreported personal income, without reducing the personal income for corporate taxes that should have been paid.[71]

In 2002 Frank M. Patti pleaded guilty to filing a false income tax return and conspiring to defraud the United States. To determine the offense level under the federal sentencing guidelines, the district court aggregated the tax revenue lost because of the unreported income of petitioner's corporation and the tax revenue lost because of petitioner's unreported personal income, without reducing the personal income for corporate taxes that should have been paid by petitioner's corporation.[72]

Whether to aggregate the losses in this manner was a question of first impression in the Eleventh Circuit. Noting that the circuits that have

---

64. *Id.* at 1043.
65. *Id.*
66. *Id.*
67. *Id.* at 1044-46.
68. *Id.* at 1045-46.
69. 337 F.3d 1317 (11th Cir. 2003).
70. *Id.* at 1323.
71. *Id.*
72. *Id.* at 1320, 1323.

considered this issue are split,[73] the Eleventh Circuit adopted the view that the sentencing guidelines require the aggregation of the tax revenue lost from the unreported corporate income and the unreported personal income without reduction for the corporate taxes that should have been paid.[74] According to the Eleventh Circuit, this interpretation is supported because falsifying a corporate income tax return and falsifying a personal income tax return are two separate crimes; thus, the losses calculated under the federal sentencing guidelines should reflect the two separate wrongs.[75] Additionally, the Eleventh Circuit pointed out that the sentencing guidelines were subsequently amended to provide that in cases involving both individual and corporate income tax returns, the loss from the corporate return and the loss from the individual return should be added together without reducing the personal income for corporate taxes that should have been paid.[76] This change was intended to be a clarifying amendment, indicating that the rule was originally intended to be applied in this way.[77] Consequently, the Eleventh Circuit held that the district court properly calculated the tax loss under the sentencing guidelines.[78]

V. RATE REDUCTION DOES NOT QUALIFY FOR TREATMENT UNDER SECTION 1341

In *Florida Progress Corp. v. Commissioner*,[79] the Eleventh Circuit affirmed a Tax Court decision holding that amounts paid by a public utility to customers as bill credits were rate reductions rather than refunds.[80] Thus, the bill credits did not qualify for preferential tax treatment under Section 1341.[81]

Florida Progress Corporation operated Florida Power Corporation, a public utility providing electricity service to retail and wholesale

73. *Id.* at 1323; *see, e.g.*, United States v. Martinez-Rios, 143 F.3d 662, 672 (2d Cir. 1998) (holding that the unreported personal income should be reduced by the amount of the tax that should have been paid on the unreported corporate income for purposes of determining the tax revenue lost); *but see* United States v. Cseplo, 42 F.3d 360, 364-65 (6th Cir. 1994) (holding that the unreported income should not be reduced by the amount of the tax that should have been paid on the unreported corporate income because the amount of income the individual actually received was not reduced by the payment of any taxes).

74. *Patti*, 337 F.3d at 1323-24.

75. *Id.* at 1324.

76. *Id.* (citing U.S. SENTENCING GUIDELINES MANUAL § 2T1.1, cmt. n.7 (2003)).

77. *See* U.S. SENTENCING GUIDELINES MANUAL app. C (Vol. II) at 182 (2003).

78. *Patti*, 337 F.3d at 1324.

79. 348 F.3d 954 (11th Cir. 2003).

80. *Id.* at 963.

81. *Id.*

customers in central and northern Florida. Florida Power was subject to the rules and regulations of both the Florida Public Service Commission ("FPSC"), which regulates the rates that utilities in Florida can charge retail customers, and the Federal Energy Regulatory Commission ("FERC"), which regulates the rates energy providers can charge wholesale customers. As one component of its regulated rates, Florida Power was permitted to include its anticipated tax liabilities in its cost of providing electricity. Florida Power's actual tax liability in any given year, however, could differ from its tax liability as calculated for ratemaking purposes because of differences between tax accounting and ratemaking accounting. As a result, Florida Power sometimes collected more for taxes than it actually had to pay. Any excess amount was put into a deferred tax account until the differences between the accounting methods reversed themselves over time.[82]

In 1986 Congress substantially lowered the corporate income tax rate, thereby significantly reducing Florida Power's anticipated income tax liability. The FPSC, responding to this windfall, ordered Florida Power to reduce its rates and issue bill credits to its retail customers to return the excess amounts it had collected for taxes. In addition, Florida Power agreed to return excess deferred income taxes to its wholesale customers during the 1987 and 1988 tax years. However, because Florida Power was unable to reach a settlement agreement with its wholesale customers for either 1987 or 1988 until after the first of each year, Florida Power did not issue bill credits to its wholesale customers in the early months of those years. Instead, after the settlement agreement was reached, it provided checks to those customers in lieu of those credits.[83]

Florida Power sought to treat the bill credits and checks as refunds eligible for treatment under section 1341. Section 1341 arose out of Congress's recognition that the tax consequences of including an item in income in one taxable year and deducting it in another may be very disadvantageous to the taxpayer if the taxpayer's tax situation changes between the year of inclusion and the year of deduction.[84] For example, a taxpayer might include a payment in income in year one, in which the taxpayer is in a high tax bracket. In year two, the taxpayer might discover that it had no right to the payment and be forced to disgorge it. If the taxpayer otherwise has no tax liability in year two or is taxed at a lower rate than in year one, a deduction for the disgorgement of the payment in year two is worth less to the taxpayer than the taxes

82. *Id.* at 955-56.
83. *Id.* at 956.
84. *See id.*

imposed on the taxpayer when it included the item in income. The taxpayer would prefer to deduct the payment from its income in year one, essentially treating the payment as though it had never been included in income. Section 1341 is designed to give the taxpayer the option to be treated as though it could deduct the payment in year one.

Section 1341 sets forth three requirements for taking advantage of its protective provision.[85] First, the item must have been included in the taxable income of the taxpayer in a prior taxable year or years because it appeared that the taxpayer had an unrestricted right to such item.[86] Second, a deduction must be available to the taxpayer in the current taxable year because it was established after the close of the prior taxable year that the taxpayer did not have an unrestricted right to such item.[87] Finally, the amount of the deduction must exceed $3000.[88] If these prerequisites are met, the taxpayer may elect to deduct the item from the current year's taxes or claim a tax credit equal to the amount by which the taxpayer's taxes were increased in the previous year because of the inclusion of the item in income.[89] The first and third requirements were clearly met in the instant case; the Eleventh Circuit thus focused on the second requirement—that the taxpayer be entitled to a deduction for the item.[90]

Under section 162(a), a taxpayer may claim a deduction for refunds it pays to customers.[91] Florida Power argued that the bill credits were refunds of amounts previously collected, and it was thus entitled to an ordinary and necessary business expense deduction under section 162(a).[92]

The Eleventh Circuit rejected this argument.[93] At trial, the Tax Court had found that the bill credits were disguised rate reductions rather than refunds eligible for a deduction under section 162(a), so the key issue was the applicable standard of review of this finding.[94] The Eleventh Circuit noted that the difference between a refund and a rate reduction is not statutorily or judicially defined.[95] Thus, the Eleventh Circuit held that the Tax Court's determination was a finding of fact

---

85. I.R.C. § 1341(a) (2000).
86. *Id.* § 1341(a)(1).
87. *Id.* § 1341(a)(2).
88. *Id.* § 1341(a)(3).
89. *Id.* § 1341(a)(4), (a)(5).
90. *Florida Progress Corp.*, 348 F.3d at 958-59.
91. I.R.C. § 162(a) (2000).
92. *Florida Progress Corp.*, 348 F.3d at 959.
93. *Id.* at 963.
94. *Id.* at 959.
95. *Id.* at 960.

because the Tax Court was drawing inferences from facts, rather than applying and weighing factors mandated by Congress or judicial precedent, and should be overturned only upon a finding that the Tax Court had clearly erred.[96]

To support its finding, the Tax Court had noted that no interest had been paid on the amounts credited to customers, Florida Power set off the amounts to be refunded against future amounts owed for its services rather than actually returning money to customers, and credits were based on current consumption rather than on the amounts each customer had actually overpaid.[97] The Eleventh Circuit held that the record supported the Tax Court's determination that the credits were nondeductible rate reductions rather than refunds eligible for a deduction under section 162(a).[98]

The Eleventh Circuit distinguished *Dominion Resources, Inc. v. United States*,[99] a case in which the United States Court of Appeals for the Fourth Circuit held that a lump sum repayment to customers of excess taxes that a utility had collected was a refund eligible for deduction under section 162(a) and for the protection of section 1341.[100] The Eleventh Circuit reasoned that a lump sum payment was materially different from the payments in the instant case, which were spread over a twelve-month period in the form of bill credits.[101] A lump sum payment, the Eleventh Circuit reasoned, was more likely to reach the customers who had actually been overcharged because a lump sum payment is closer in time to the overcharge.[102]

Florida Power argued in the alternative that section 1341 itself gave rise to a deduction that would entitle Florida Power to the protections afforded by section 1341.[103] The Eleventh Circuit easily disposed of this argument.[104] Section 1341(a)(2) requires that a deduction be "allowable for the taxable year because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item."[105] Section 1341 itself does not indicate whether such a deduction is allowable. Furthermore, the regulations interpreting section 1341 explicitly provide that a deduction

---

96. *Id.* at 963.
97. *Id.* at 961-62.
98. *Id.* at 963.
99. 219 F.3d 359 (4th Cir. 2000).
100. *Id.* at 369, 370.
101. *Florida Progress Corp.*, 348 F.3d at 963.
102. *Id.*
103. *Id.* at 958.
104. *Id.* at 959.
105. I.R.C. § 1341(a)(2) (2000).

must arise "under other provisions of chapter 1 of the Internal Revenue Code"[106] for the protections of section 1341 to be available.[107] The Eleventh Circuit concluded that eligibility for treatment under section 1341 must be based on a deduction arising under another section of the Code.[108] Here, Florida Power was not entitled to a deduction under section 162(a) because the credits were rate reductions rather than refunds; thus, Florida Power failed to qualify for the protection of section 1341.[109]

106. 26 C.F.R. § 1.1341-1(a)(1) (as amended in 1996).
107. *Id.*
108. *Florida Progress Corp.*, 348 F.3d at 959.
109. *Id.* at 963.