

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

FILED

2008 NOV 25 PM 4: 10

CLERK US DISTRICT COURT
WESTERN DISTRICT OF TEXAS

BY Kw
DEPUTY

J. WINSTON and SHERI S. KRAUSE

Plaintiffs,

v.

UNITED STATES of AMERICA

Defendant

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CIVIL ACTION NO.

A08CA 865 SS

PLAINTIFFS' COMPLAINT

Plaintiffs bring this action pursuant to the Internal Revenue Code of 1986 (the "Code"), 26 U.S.C. §1, *et seq.*, claiming a refund of income taxes, penalties and interest paid along with all other amounts to which they are entitled to be refunded, including interest, and for other appropriate relief.

I. PARTIES

1. J. Winston Krause and Sheri S. Krause (the "Krauses") are married adult individuals residing in Austin, Travis County, Texas.
2. Defendant, the United States of America, may be served with process upon:
 - (a) the Civil Process Clerk, Office of the United States Attorney, 816 Congress Ave., Suite 1000, Austin, TX 78701; and
 - (b) the Attorney General of the United States, Department of Justice, 950 Pennsylvania Avenue, NW, Washington, D.C. 20530-0001.

II. JURISDICTION AND VENUE

3. Plaintiffs filed their claim for refund on March 6, 2008. A true and accurate copy of the claim for refund is attached as Exhibit A (Bates No. PL0001-0002) along with the U.S. Postal Service Certified Mail Receipt Postmark.
4. More than six months have elapsed since Plaintiffs filed their claim and Defendant has taken no action to allow or deny Plaintiffs' claim for refund.

5. This Court has original jurisdiction over the subject matter of this action pursuant to 26 U.S.C. §7422(a).

6. Venue is proper in this jurisdiction under 28 U.S.C. §1391(e)(2) and (3).

III. OVERVIEW OF FACTS

7. Attached as Exhibit B is a true and correct copy of the IRS' Transcript of Account for Plaintiffs for the 2002 and 2003 tax years (Bates No. PL0003 – 0006).

8. On January 4, 2007, the IRS issued the Notice of Deficiency to the Krauses for tax years 2002 and 2003 and a true and correct copy of which is attached as Exhibit C. (Bates Nos. PL0007 - PL0033).

2002 Tax Year

9. In October, 2003, the Plaintiffs filed their 2002 tax return with the Internal Revenue Service which it received on November 17, 2003 (See PL0004).

10. The 2002 tax return included a loss in the amount of \$2,791,429.

11. Their income tax as originally reported was zero. (See 2002 Transcript of Account PL0004).

12. The Notice of Deficiency disallowed the \$2,791,429 loss deduction (See PL0009-Line 16) and determined the Plaintiffs' 2002 income tax without that loss to be \$155,439. (See PL0007 and PL0009 – Line 16).

13. The other following described adjustments occur automatically due to the IRS disallowing the \$2,791,429 loss deduction: itemized deductions, personal exemptions and the SE AGI Adjustment. (See PL0009 – Lines 1d, e and f).

14. The other two adjustments of \$2,791,250 and (\$2,791,250) set off against each other exactly. (See PL0009 – Lines 1a and c).

15. The Notice of Deficiency determined an increase in tax of \$155,439 for 2002. (See PL0009 – Line 16).

16. The Notice of Deficiency determined a 40 percent Gross Valuation Misstatement penalty of \$62,175.60 pursuant to Code §6662(h) for 2002. (See PL0007 and PL0010).

17. The Notice of Deficiency sets forth the IRS' determination of the Valuation Misstatement penalty for 2002. (See PL0007, PL0010 – Line 10b and PL0033).
18. The 2002 penalty amount of \$62,175.20 is exactly forty percent of the increase in income tax of \$155,439.
19. The IRS assessed \$41,771.42 of interest on the 2002 interest and tax and penalty. (See PL0015).
20. The amount of interest assessed on the penalty is \$13,783.26 (See PL0004).
21. Plaintiffs' 2002 Transcript of Account reflects no outstanding amount due the IRS. (See PL0004).

2003 Tax Year

22. In October, 2004, the Plaintiffs filed their 2003 tax return with the Internal Revenue Service which receive the return on October 19, 2004. (See PL0005).
23. The Plaintiffs' 2003 tax return included a loss carried over from 2002. Their income tax as originally reported was zero. (See PL0006).
24. The Plaintiffs amended their 2003 tax return which the IRS received on November 20, 2004 (See PL0006).
25. The amended 2003 return recalculated their 2003 income tax without the loss carried over from 2002.
26. Plaintiffs paid additional tax of \$50,259 which the IRS received on November 20, 2004. (See PL0006).
27. The October 6, 2006 Notice of Deficiency attached as Exhibit C recalculated Plaintiffs' 2003 income tax both without the loss as originally filed but also without itemized (charitable contribution) deductions carried over from 2002 disallowed due to the recalculation of 2002 taxes. (See PL0009).
28. The 2003 tax increase resulted from the IRS disallowing the loss deduction originally claimed and from the IRS disallowing the 2002 loss deduction (which caused charitable itemized deductions to no longer carry over from 2002 to 2003).

29. The Notice of Deficiency determined the Plaintiffs' 2003 income tax without the disallowed deductions to be \$77,702. (Se PL0009).
30. The Notice of Deficiency determined a 40 percent Gross Valuation Misstatement penalty of \$31,082 pursuant to Code §6662(h) for 2003. (See PL0010 and PL0033).
31. The Notice of Deficiency sets forth the IRS' computation of the Valuation Misstatement penalty for 2003.
32. The 2003 penalty of \$31,082 is forty percent of the increase in income tax of \$77,702.
33. The IRS assessed interest on November 19, 2008 in the amount of \$10,215.50. The portion allocable to the 2003 penalty is $\$10,215.50 \times [\$31,082 / (\$31,082 + \$27,443)] = \$5,425.34$. (See PL0006).
34. Plaintiffs paid the increase in tax, penalty and interest at the dates reflected on the 2003 Transcript of Account. (See PL0006).
35. The 2003 Transcript of Account reflects no amounts currently due to the IRS. (See PL0006).

IV. CAUSE OF ACTION

36. The preceding facts and allegations are incorporated herein by reference.
37. Defendant assessed an accuracy-related penalty described in Code §6662(e) as a "Substantial Valuation Misstatement Under Chapter 1" augmented pursuant to Code §6662(h)(1) from 20 percent to 40 percent.
38. Thus, based on disallowing Plaintiffs' loss deduction for 2002, Defendant assessed not only additional income tax of \$155,439 plus also assessed a 2002 Valuation Misstatement penalty of 40% in an amount equal to \$62,175.60.
39. And based on disallowing Plaintiffs' loss deduction and a charitable deduction for 2003, Defendant assessed not only additional income tax but also assessed a 2003 Valuation Misstatement penalty of 40% in an amount equal to \$31,082.
40. The Defendant may not assess a Valuation Misstatement accuracy-related penalty on Plaintiffs pursuant to Code § 6662(e) and (h) when it merely disallows a deduction.

41. In this case, Defendant merely disallowed a loss deduction for 2002 yet still assessed a Valuation Misstatement accuracy-related penalty of \$62,175.60 and interest thereon of \$11,934 for a total of \$74,109.60 for which Plaintiffs make claim.

42. And for 2003, Defendant merely disallowed a loss deduction and a charitable deduction yet still assessed a Valuation Misstatement accuracy-related penalty of \$31,082 and interest thereon of \$5,425.34 for a total of \$36,507.34 for which Plaintiffs make claim.

43. Plaintiffs' claims for both years cumulatively equal \$112,466.20.

44. In *Heasley v. Commissioner*,¹ the United States Court of Appeals for the Fifth Circuit affirmed its ruling in *Todd v. Commissioner*² that, "whenever the I.R.S. totally disallows a deduction or credit, the I.R.S. may not penalize the taxpayer for a valuation overstatement included in that deduction or credit." *Heasley* at 383. The reasoning of the *Heasley* and *Todd* Courts controls in this matter: viz., the IRS may not penalize taxpayers with a valuation overstatement that does not exist when it disallows losses on deductions.

45. To the extent allowed by Code §7430, Plaintiffs make claim for administrative fees and attorney and other fees and costs.

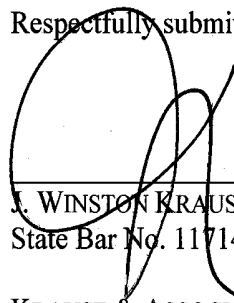
¹ *Heasley v. Commissioner*, 902 F.2d 380 (5th Cir. 1990).

² *Todd v. Commissioner*, 862 F.2d 540 (5th Cir. 1988).

V. RELIEF SOUGHT

46. Plaintiffs request that the Court (a) determine Plaintiffs' claims herein; (b) enter a monetary judgment in favor of Plaintiffs for \$112,466.20 plus interest and attorney fees; and (c) grant Plaintiffs such further legal and equitable relief as the Court may deem and proper.

Respectfully submitted,



J. WINSTON KRAUSE,
State Bar No. 11714550

KRAUSE & ASSOCIATES LP
P.O. Box 5399
Austin, Texas 78763-5399
512.477.6707
512.477.6708 fax

ATTORNEY FOR PLAINTIFFS

JS 44 (Rev. 12/07)

CIVIL COVER SHEET

The JS 44 civil cover sheet and the information contained herein neither replace nor supplement the filing and service of pleadings or other papers as required by law, except as provided by local rules of court. This form, approved by the Judicial Conference of the United States in September 1974, is required for the use of the Clerk of Court for the purpose of initiating the civil docket sheet. (SEE INSTRUCTIONS ON THE REVERSE OF THE FORM.)

I. (a) PLAINTIFFS
 J. Winston and Sheri S. Krause
 3605 Balcones Drive
 Austin, TX 78731

(b) County of Residence of First Listed Plaintiff Travis
 (EXCEPT IN U.S. PLAINTIFF CASES)

(c) Attorney's (Firm Name, Address, and Telephone Number)
 Krause & Associates, LP
 504 West 13th Street, Austin, TX 78701 (512) 477-6707

DEFENDANTS
 United States of America
 Washington, DC

County of Residence of First Listed Defendant Travis
 (IN U.S. PLAINTIFF CASES ONLY)

NOTE: IN LAND CONDEMNATION CASES, USE THE LOCATION OF THE LAND INVOLVED.

Attorneys (If Known) **A08CA 865SS**

II. BASIS OF JURISDICTION (Place an "X" in One Box Only)

1 U.S. Government Plaintiff

2 U.S. Government Defendant

3 Federal Question (U.S. Government Not a Party)

4 Diversity (Indicate Citizenship of Parties in Item III)

III. CITIZENSHIP OF PRINCIPAL PARTIES (Place an "X" in One Box for Plaintiff and One Box for Defendant)

	PTF	DEF		PTF	DEF
Citizen of This State	<input checked="" type="checkbox"/> 1	<input type="checkbox"/> 1	Incorporated or Principal Place of Business In This State	<input type="checkbox"/> 4	<input type="checkbox"/> 4
Citizen of Another State	<input type="checkbox"/> 2	<input type="checkbox"/> 2	Incorporated and Principal Place of Business In Another State	<input type="checkbox"/> 5	<input type="checkbox"/> 5
Citizen or Subject of a Foreign Country	<input type="checkbox"/> 3	<input type="checkbox"/> 3	Foreign Nation	<input type="checkbox"/> 6	<input type="checkbox"/> 6

IV. NATURE OF SUIT (Place an "X" in One Box Only)

CONTRACT	TORTS	FORFEITURE/PENALTY	BANKRUPTCY	OTHER STATUTES
<input type="checkbox"/> 110 Insurance <input type="checkbox"/> 120 Marine <input type="checkbox"/> 130 Miller Act <input type="checkbox"/> 140 Negotiable Instrument <input type="checkbox"/> 150 Recovery of Overpayment & Enforcement of Judgment <input type="checkbox"/> 151 Medicare Act <input type="checkbox"/> 152 Recovery of Defaulted Student Loans (Excl. Veterans) <input type="checkbox"/> 153 Recovery of Overpayment of Veteran's Benefits <input type="checkbox"/> 160 Stockholders' Suits <input type="checkbox"/> 190 Other Contract <input type="checkbox"/> 195 Contract Product Liability <input type="checkbox"/> 196 Franchise	PERSONAL INJURY <input type="checkbox"/> 310 Airplane <input type="checkbox"/> 315 Airplane Product Liability <input type="checkbox"/> 320 Assault, Libel & Slander <input type="checkbox"/> 330 Federal Employers' Liability <input type="checkbox"/> 340 Marine <input type="checkbox"/> 345 Marine Product Liability <input type="checkbox"/> 350 Motor Vehicle <input type="checkbox"/> 355 Motor Vehicle Product Liability <input type="checkbox"/> 360 Other Personal Injury	PERSONAL INJURY <input type="checkbox"/> 362 Personal Injury - Med. Malpractice <input type="checkbox"/> 365 Personal Injury - Product Liability <input type="checkbox"/> 368 Asbestos Personal Injury Product Liability PERSONAL PROPERTY <input type="checkbox"/> 370 Other Fraud <input type="checkbox"/> 371 Truth in Lending <input type="checkbox"/> 380 Other Personal Property Damage <input type="checkbox"/> 385 Property Damage Product Liability	<input type="checkbox"/> 610 Agriculture <input type="checkbox"/> 620 Other Food & Drug <input type="checkbox"/> 625 Drug Related Seizure of Property 21 USC 881 <input type="checkbox"/> 630 Liquor Laws <input type="checkbox"/> 640 R.R. & Truck <input type="checkbox"/> 650 Airline Regs. <input type="checkbox"/> 660 Occupational Safety/Health <input type="checkbox"/> 690 Other	<input type="checkbox"/> 400 State Reapportionment <input type="checkbox"/> 410 Antitrust <input type="checkbox"/> 430 Banks and Banking <input type="checkbox"/> 450 Commerce <input type="checkbox"/> 460 Deportation <input type="checkbox"/> 470 Racketeer Influenced and Corrupt Organizations <input type="checkbox"/> 480 Consumer Credit <input type="checkbox"/> 490 Cable/Sat TV <input type="checkbox"/> 810 Selective Service <input type="checkbox"/> 850 Securities/Commodities/Exchange <input type="checkbox"/> 875 Customer Challenge 12 USC 3410 <input type="checkbox"/> 890 Other Statutory Actions <input type="checkbox"/> 891 Agricultural Acts <input type="checkbox"/> 892 Economic Stabilization Act <input type="checkbox"/> 893 Environmental Matters <input type="checkbox"/> 894 Energy Allocation Act <input type="checkbox"/> 895 Freedom of Information Act <input type="checkbox"/> 900 Appeal of Fee Determination Under Equal Access to Justice <input type="checkbox"/> 950 Constitutionality of State Statutes
REAL PROPERTY	CIVIL RIGHTS	PRISONER PETITIONS	LABOR	SOCIAL SECURITY
<input type="checkbox"/> 210 Land Condemnation <input type="checkbox"/> 220 Foreclosure <input type="checkbox"/> 230 Rent Lease & Ejectment <input type="checkbox"/> 240 Torts to Land <input type="checkbox"/> 245 Tort Product Liability <input type="checkbox"/> 290 All Other Real Property	<input type="checkbox"/> 441 Voting <input type="checkbox"/> 442 Employment <input type="checkbox"/> 443 Housing/Accommodations <input type="checkbox"/> 444 Welfare <input type="checkbox"/> 445 Amer. w/Disabilities - Employment <input type="checkbox"/> 446 Amer. w/Disabilities - Other <input type="checkbox"/> 440 Other Civil Rights	<input type="checkbox"/> 510 Motions to Vacate Sentence Habeas Corpus: <input type="checkbox"/> 530 General <input type="checkbox"/> 535 Death Penalty <input type="checkbox"/> 540 Mandamus & Other <input type="checkbox"/> 550 Civil Rights <input type="checkbox"/> 555 Prison Condition	<input type="checkbox"/> 710 Fair Labor Standards Act <input type="checkbox"/> 720 Labor/Mgmt. Relations <input type="checkbox"/> 730 Labor/Mgmt. Reporting & Disclosure Act <input type="checkbox"/> 740 Railway Labor Act <input type="checkbox"/> 790 Other Labor Litigation <input type="checkbox"/> 791 Empl. Ret. Inc. Security Act	<input type="checkbox"/> 820 Copyrights <input type="checkbox"/> 830 Patent <input type="checkbox"/> 840 Trademark <input type="checkbox"/> 861 HIA (1395ff) <input type="checkbox"/> 862 Black Lung (923) <input type="checkbox"/> 863 DIWC/DIWW (405(g)) <input type="checkbox"/> 864 SSID Title XVI <input type="checkbox"/> 865 RSI (405(g))
			FEDERAL TAX SUITS	
			<input checked="" type="checkbox"/> 870 Taxes (U.S. Plaintiff or Defendant) <input type="checkbox"/> 871 IRS—Third Party 26 USC 7609	

V. ORIGIN (Place an "X" in One Box Only)

1 Original Proceeding

2 Removed from State Court

3 Remanded from Appellate Court

4 Reinstated or Reopened

5 Transferred from another district (specify)

6 Multidistrict Litigation

7 Appeal to District Judge from Magistrate Judgment

VI. CAUSE OF ACTION

Cite the U.S. Civil Statute under which you are filing (Do not cite jurisdictional statutes unless diversity):
Tax Refund 26 USC Sec. 7422(a)

Brief description of cause:
Refund of Penalty

VII. REQUESTED IN COMPLAINT:

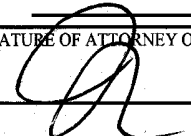
CHECK IF THIS IS A CLASS ACTION UNDER F.R.C.P. 23

DEMAND \$ _____

CHECK YES only if demanded in complaint:
JURY DEMAND: Yes No

VIII. RELATED CASE(S) IF ANY (See instructions):

JUDGE _____ DOCKET NUMBER _____

DATE 11/25/08 SIGNATURE OF ATTORNEY OF RECORD 

FOR OFFICE USE ONLY

RECEIPT # _____ AMOUNT _____ APPLYING IFP _____ JUDGE _____ MAG. JUDGE _____

Court Name: TEXAS WESTERN
Division: 1
Receipt Number: 1000003332
Cashier ID: kwallace
Transaction Date: 11/25/2008
Payer Name: KRAUSE AND ASSOCIATES LP

CIVIL FILING FEE
For: KRAUSE AND ASSOCIATES LP
Amount: \$350.00

CHECK

Check/Money Order Num: 7430
Amt Tendered: \$350.00

Total Due: \$350.00
Total Tendered: \$350.00
Change Amt: \$0.00

1:08CV865; J WINSTON KRAUSE, ET AL
VS USA