

Strengthen Taxpayer Rights in Judicial Proceedings

#50 REPEAL FLORA: GIVE TAXPAYERS WHO CANNOT PAY THE SAME ACCESS TO JUDICIAL REVIEW AS THOSE WHO CAN

Present Law

IRC § 6212 requires the IRS to issue a “notice of deficiency” before assessing certain liabilities. When the IRS issues a notice of deficiency, IRC § 6213 authorizes the taxpayer to petition the U.S. Tax Court within 90 days (or 150 days if the notice is addressed to a person outside the U.S.) to review the IRS determination.

IRC §§ 6201 and 6671(a) authorize the IRS to assess other liabilities, including so-called “assessable” penalties (e.g., penalties codified in IRC §§ 6671-6725), without first issuing a notice of deficiency. Assessable penalties are not computed by reference to a tax deficiency. For example, penalties under IRC §§ 6721 and 6707 for failure to file various information returns are assessable penalties. A taxpayer generally may not obtain judicial review of assessable penalties in the Tax Court.

28 U.S.C. § 1346(a)(1) provides that a taxpayer may sue in a U.S. District Court or the U.S. Court of Federal Claims to recover “any sum” that the taxpayer believes has been erroneously assessed or collected. In *Flora v. United States*, 362 U.S. 145 (1960), however, the U.S. Supreme Court held that, with limited exceptions, a taxpayer must have “fully paid” the assessment (called the “full payment rule”) before suing in these courts. In contrast, IRC § 7422(j) provides that the U.S. District Courts and the U.S. Court of Federal Claims “shall not fail to have jurisdiction” to determine the “estate tax liability of such estate (or for any refund with respect thereto) solely because the full amount of such liability has not been paid by reason of an election under section 6166” to pay the liability in installments.

Under IRC § 7422(a) the taxpayer must make a timely administrative claim for refund before filing suit. Assuming the claim is timely, IRC § 6511(b)(2) generally limits a taxpayer’s recovery to amounts paid within two years (or, in some cases, within three-years plus any extension of time to file) before the date of the claim.¹⁵⁹

Under IRC §§ 6330 and 6320, the Tax Court may review an assessed liability if the IRS issues levies or liens to collect an assessment and the taxpayer requests a Collection Due Process (CDP) hearing. However, IRC §§ 6330(c)(2)(B), 6320(c), and Treas. Reg. §§ 301.6320-1(e)(3)A-E2 and 301.6330-1(e)(3)A-E2, provide that the Tax Court may do so only if the taxpayer did not receive a notice of deficiency and did not have an opportunity to raise the dispute in an administrative appeal. In practice, the IRS generally provides an opportunity for an administrative appeal.

Under 11 U.S.C. § 505(a)(1), a bankruptcy court “may” review a tax dispute, but it generally will not review tax issues unless resolution of the dispute would benefit the taxpayer’s other creditors.

¹⁵⁹ To be timely, IRC § 6511(a) generally requires that an administrative claim must be filed within the later of (i) three years from when the original return was filed or (ii) two years from when the tax was paid. If the claim is filed within the three-year period, then IRC § 6511(b)(2)(A) provides that the taxpayer can only recover amounts paid within three years, plus any extension of time to file, before the date of the claim. Otherwise, IRC § 6511(b)(2)(B) provides that the taxpayer can only recover amounts paid within two years before the date of the claim.

Under IRC § 7803(a)(3), the Commissioner is required to ensure that IRS employees act in accord with certain rights (known as the “Taxpayer Bill of Rights”), including the *right to appeal a decision of the Internal Revenue Service in an independent forum*.

Reasons for Change

Consistent with the Taxpayer Bill of Rights, all taxpayers should have an opportunity to obtain judicial review of adverse IRS determinations. Moreover, taxpayers who cannot pay what the IRS says they owe in order to challenge an adverse determination should have the same opportunities as wealthier taxpayers who can pay.

Under current law, there are circumstances in which taxpayers do not have a right to judicial review. Significantly, assessable penalties are not subject to judicial review unless the taxpayer is wealthy enough to fully pay.

Even taxpayers who fully pay may lose the opportunity to recover a portion of their payments if they pay in installments. Payments made more than two years before a taxpayer fully pays and files a refund claim generally cannot be recovered. Thus, a taxpayer who is not affluent enough to pay his alleged debt within two years will lose the right to request a refund of his early payments, even if he eventually pays in full and the court agrees with him on the merits of the refund claim.

Even when the IRS sends the notice of deficiency to low income taxpayers, they may not have a realistic opportunity for judicial review. A TAS study found that when the IRS sent an audit notice to those claiming the Earned Income Tax Credit (EITC)—a refundable tax credit for the working poor—almost 40 percent did not understand what the IRS was questioning, and only about half of the respondents felt that they knew what they needed to do. Thus, many are also unlikely to understand whether and how to timely petition the Tax Court.

Since the *Flora* case was decided, the problems created by the full payment rule have grown while the reasons for it have faded. Specifically, whether judicial review occurs before or after payment is not as important to the government as it once was. Moreover, in 1960 when *Flora* was decided, there were only four assessable penalties. Today, there are over 50. Thus, the IRS’s authority to assess penalties that cannot be reviewed has increased. In addition, the EITC was not enacted until 1975. It brought the working poor into the tax system by giving them tax benefits. Thus, the full payment rule increasingly erodes the *right to appeal an IRS decision in an independent forum* for tens of millions who were not a part of the tax system in 1960.

The National Taxpayer Advocate recommends that Congress provide all taxpayers with a realistic opportunity to obtain judicial review of adverse IRS determinations without regard to ability pay.

Recommendations¹⁶⁰

While a simple solution might be to repeal the full payment rule, Congress should also consider one or more of the following options:¹⁶¹

- Amend 28 U.S.C. § 1346(a)(1) to clarify that the full payment rule only applies in cases where the taxpayer has received a notice of deficiency.

¹⁶⁰ For more detail, see National Taxpayer Advocate 2018 Annual Report to Congress (Legislative Recommendation: *Fix the Flora Rule: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*).

¹⁶¹ The doctrines of *res judicata* and *collateral estoppel* should help ensure the IRS does not re-litigate the same issues with respect to unpaid liabilities. See, e.g., CCDM 34.5.1.1.2.2.4 (Aug. 11, 2004).

- Treat a taxpayer as having fully paid a disputed amount for purposes of the full payment rule when the taxpayer has paid some of it (including by refund offset) and either (a) the IRS has classified the account as currently not collectible due to economic hardship or (b) the taxpayer has entered into an agreement to pay the liability in installments.¹⁶²
- Authorize the U.S. Tax Court to review liabilities where the taxpayer has not received a deficiency notice (*e.g.*, assessable penalties) in a manner that parallels the deficiency process. Alternatively, expand the Tax Court's jurisdiction to review these liabilities in connection with CDP appeals, even if the taxpayer has had an opportunity for an *administrative* appeal.

¹⁶² As noted above, a similar rule applies to estates that elect to pay in installments. See IRC § 7422(j).

#51 PROVIDE THAT THE TIME LIMITS FOR BRINGING TAX LITIGATION ARE SUBJECT TO THE JUDICIAL DOCTRINES OF FORFEITURE, WAIVER, ESTOPPEL AND EQUITABLE TOLLING

Present Law

Various provisions in the IRC authorize proceedings or suits against the government, provided such actions are brought timely. These actions are generally brought in the United States Tax Court, a United States District Court, or the United States Court of Federal Claims.¹⁶³

Equitable doctrines which, if available, might excuse an untimely filing include equitable tolling (applicable when it is unfair to hold a plaintiff to a statutory deadline because of an extraordinary event that impeded the plaintiff's compliance); equitable estoppel (applicable when it is unfair to allow the defendant to benefit from the statutory deadline because of something the defendant did to prevent a timely suit); forfeiture (applicable when the parties have acted as if the case need not operate under the statutory deadlines); and waiver (applicable when the parties have agreed explicitly that a case need not operate under legal deadlines).

United States Tax Court

For some types of tax controversies, the United States Tax Court is the only judicial forum in which taxpayers, by filing a petition within a specified period; may litigate their tax liability without first paying the tax asserted. Examples of these types of controversies include deficiency proceedings, collection due process (CDP) proceedings, and "stand-alone" innocent spouse cases (*i.e.*, where innocent spouse relief is sought other than in response to a statutory notice of deficiency or as part of a CDP proceeding).

Other types of cases brought in the Tax Court include interest abatement cases, worker classification cases, and whistleblower claims.

IRC § 7442, which describes the jurisdiction of the Tax Court, does not specify that prescribed periods for petitioning the Tax Court are not subject to equitable doctrines.

The Tax Court has held that, in the absence of a timely filed petition, it does not have jurisdiction to re-determine deficiencies, hear appeals from IRS CDP proceedings, or consider stand-alone innocent spouse claims.

With respect to deficiency cases and stand-alone innocent spouse cases, several United States Courts of Appeals have agreed with the Tax Court that the time limits for filing a Tax Court petition are jurisdictional requirements that cannot be modified by applying equitable doctrines.

Other Federal Courts

In some cases, taxpayers have the right to obtain judicial review in federal courts other than the Tax Court if they sue within a specified period. For example, a refund suit can generally be brought in the United States District Courts or in the United States Court of Federal Claims within two years after the IRS denies the

¹⁶³ Some tax claims may also be heard by United States bankruptcy courts. For a fuller discussion of this recommendation, see National Taxpayer Advocate 2017 Annual Report to Congress 283 (Legislative Recommendation: *Make the Time Limits for Bringing Tax Litigation Subject to the Judicial Doctrines of Forfeiture, Waiver, Estoppel, and Equitable Tolling, and Clarify That Dismissal of an Untimely Petition Filed in Response to a Statutory Notice of Deficiency Is Not a Decision on the Merits of a Case*).

claim. There is a split between circuits regarding whether the statutory period for seeking refunds is subject to equitable doctrines.¹⁶⁴

Similarly, taxpayers may sue in a U.S. District Court to enjoin enforcement of a wrongful levy or sale, or to recover property (or proceeds from the sale of the property) if they do so within a specified period (generally, within two years of levy). Several federal courts have held that the applicable period is not subject to equitable tolling,¹⁶⁵ but at least one appellate court has held that it is.¹⁶⁶

Taxpayers may also bring suit, if they do so within the specified periods, to seek civil damages in a United States District Court or bankruptcy court with respect to unauthorized actions by the IRS. Courts have differed on whether equitable doctrines can toll the applicable period for bringing suit.¹⁶⁷

Reasons for Change

The sanction for failing to commence suit in the Tax Court or another federal court within the time limits prescribed by the IRC is severe: taxpayers lose their day in that court, which may be the only prepayment forum, or the only forum at all, with jurisdiction to hear their claim. Treating the IRC time limits for bringing suit as jurisdictional, and not subject to equitable doctrines, leads to unfair outcomes.

Unrepresented taxpayers, in particular, may be less likely to anticipate the severe consequences of filing a Tax Court petition even one day late, and most Tax Court petitioners do not have representation. The IRS itself occasionally provides inaccurate information regarding the filing deadline to a taxpayer, and taxpayers have been harmed by relying on that erroneous information.¹⁶⁸

The right to a fair and just tax system requires that equitable doctrines be available to taxpayers in the rare cases they would apply. Taxpayers would still be required to demonstrate that an equitable doctrine applies in their cases, and courts could still dismiss petitions or complaints as untimely.

¹⁶⁴ Compare *RHI Holdings, Inc. v. U.S.*, 142 F.3d 1459, 1460-1463 (Fed. Cir. 1998) (declining to apply equitable principles to § 6352) with *Wagner v. U.S.*, 2018-2 U.S.T.C. (CCH) ¶50,496 (E.D. Wash. 2018) (the time limits set forth in § 6532 are not jurisdictional; furthermore, plaintiff's petition was timely filed) and *Howard Bank v. U.S.*, 759 F. Supp. 1073, 1080 (D. Vt. 1991), *aff'd*, 948 F.2d 1275 (2d Cir. 1991) (applying equitable principles to § 6352 and estopping the IRS from raising the limitations period as a bar to suit).

¹⁶⁵ See *Becton Dickinson and Co. v. Wolckenhauer*, 215 F.3d 340, 351-354 (3d Cir. 2000) and cases cited therein (holding that IRC § 6532(c) period is not subject to equitable tolling).

¹⁶⁶ See, e.g., *Volpicelli v. U.S.*, 777 F.3d 1042, 1047 (9th Cir. 2015) (holding that IRC § 6532(c) period is subject to equitable tolling); *Supermail Cargo, Inc. v. U.S.*, 68 F.3d 1204 (9th Cir. 1995) (same).

¹⁶⁷ Compare *Aloe Vera of America, Inc. v. U.S.*, 580 F.3d 867, 871-872 (9th Cir. 2009) (time for bringing suit under IRC § 7431 is not subject to equitable tolling), with *U.S. v. Marsh*, 89 F. Supp. 2d 1171, 1177 (D. Haw. 2000) (doctrine of equitable tolling is an extraordinary remedy that did not apply in this § 7433 action), *Ramos v. U.S.*, 2002-2 U.S.T.C. (CCH) ¶50,767 (N.D. Cal. 2002) (denying motion to dismiss because doctrine of equitable tolling might apply to a § 7433 action), and *Bennett v. U.S.*, 366 F. Supp. 2d 877, 879 (D. Neb. 2005) (whether equitable tolling applies to §§ 7432 and 7433 actions has not been definitively determined, but it is an extraordinary remedy and did not apply in this case).

¹⁶⁸ See, e.g., *Naufflett v. Comm'r*, 892 F.3d 649, 652-654 (4th Cir. 2018) (doctrine of equitable tolling did not apply to innocent spouse case despite reliance on erroneous IRS advice regarding the filing deadline); *Rubel v. Comm'r*, 856 F.3d 301, 306 (3d Cir. 2017) (same).

Recommendation

Enact a new section of the IRC, or amend IRC § 7442, to provide that the periods set forth in the IRC within which taxpayers may petition the Tax Court or file suit in other federal courts are not jurisdictional and are subject to the judicial doctrines of forfeiture, waiver, estoppel, and equitable tolling.¹⁶⁹

¹⁶⁹ If this change to the IRC were enacted, late-filed claims would no longer be dismissed for lack of jurisdiction, which would mean that the taxpayer would have no right to pursue a refund suit. As a result, we are also recommending that IRC § 7459(d) be amended to make clear that a dismissal based on timeliness is not a decision on the merits.

#52 CLARIFY THAT THE SCOPE AND STANDARD OF JUDICIAL REVIEW OF DETERMINATIONS UNDER IRC § 6015 ARE *DE NOVO*

Present Law

Taxpayers who file joint federal income tax returns are jointly and severally liable for any deficiency or tax due with respect to their joint returns. IRC § 6015, sometimes referred to as the “innocent spouse” rules, provides relief from this joint and several liability. If “traditional” relief from a deficiency is unavailable under subsection (b) and “separation of liability” from a deficiency is unavailable under subsection (c), a taxpayer may qualify for “equitable” innocent spouse relief from deficiencies and underpayments under subsection (f). Relief under IRC § 6015(f) is appropriate when, taking into account all the facts and circumstances of a case, it would be inequitable to hold a joint filer liable for the unpaid tax or deficiency. If the IRS denies relief under any subsection of IRC § 6015, the taxpayer may petition the Tax Court.

In 2008, the Tax Court held that the *scope* of its review in IRC § 6015(f) cases, like its review in IRC § 6015(b) and (c) cases, is *de novo*, meaning that it may consider evidence introduced at trial that was not included in the administrative record.¹⁷⁰ In 2009, the Tax Court held that the *standard* of review in IRC § 6015(f) cases is also *de novo*, meaning that the Tax Court will consider the case anew, without deference to the agency’s determination to deny relief.¹⁷¹

In 2009, the IRS Office of Chief Counsel (Chief Counsel) issued guidance to its attorneys instructing them to argue, contrary to the Tax Court’s holdings, that the scope of review in all IRC § 6015(f) cases is limited to issues and evidence presented before the IRS Appeals or Examination functions and that the proper standard of review is abuse of discretion.¹⁷² In 2011, the National Taxpayer Advocate recommended that Congress amend IRC § 6015 to reflect the Tax Court’s holdings.

In June 2013, following an appellate court decision affirming the Tax Court’s holdings, Chief Counsel issued guidance instructing its attorneys to cease arguing that the scope and standard of review in IRC § 6015(f) cases is not *de novo*.¹⁷³ In June 2013, Chief Counsel also issued an Action on Decision stating that although the IRS disagrees that section 6015(e)(1) provides for both a *de novo* standard of review and a *de novo* scope of review, the IRS will no longer argue that the Tax Court should limit its review to the administrative record or review section 6015(f) claims solely for an abuse of discretion.¹⁷⁴

Reasons for Change

Although Chief Counsel issued an Action on Decision and issued instructions to its attorneys to stop arguing that Tax Court review in section 6015(f) cases should be limited to the administrative record and for an abuse of discretion, Chief Counsel could change its position in the future. To eliminate ambiguity and preclude

¹⁷⁰ *Porter v. Comm’r*, 130 T.C. 115 (2008).

¹⁷¹ *Porter v. Comm’r*, 132 T.C. 203 (2009) (a continuation of the same case that produced the 2008 holding, discussed above, that Tax Court review of denials of relief under IRC § 6015(f) is not limited to the administrative record).

¹⁷² Notice CC-2009-021, *Litigating Cases Involving Claims for Relief From Joint and Several Liability Under Section 6015(f): Scope and Standard of Review* (June 30, 2009).

¹⁷³ Notice CC-2013-011, *Litigating Cases that Involve Claims for Relief From Joint and Several Liability Under Section 6015* (June 7, 2013).

¹⁷⁴ Action on Decision (AOD) 2012-07, I.R.B. 2013-25 (June 17, 2013), issued in response to *Wilson v. Comm’r*, 705 F.3d 980 (9th Cir. 2013), *aff’g* T.C. Memo. 2010-134. An AOD is a formal memorandum prepared by Chief Counsel that announces the future litigation position the IRS will take with regard to the court decision addressed by the AOD.

future changes in the IRS's litigating position, the statute should be amended to clarify that courts may consider all relevant evidence in IRC § 6015 cases and that the standard of review is *de novo*.

Recommendation

Amend IRC § 6015 by adding flush language after subsection (e)(A)(iii) providing that that in any proceeding in a court with jurisdiction over a case, the scope and standard of review of determinations under IRC § 6015 is *de novo*.¹⁷⁵

¹⁷⁵ See Taxpayer First Act, H.R. 5444, 115th Cong. § 11303 (2018); Taxpayer First Act of 2018, S. 3246, 115th Cong. § 1003 (2018); Strengthening Taxpayer Rights Act, H.R. 3340, 115th Cong. § 202 (2017); Taxpayer Protection Act, S. 3156, 114th Cong. § 113 (2016); Taxpayer Rights Act, H.R. 4128 and S. 2333, 114th Cong. § 303 (2015). While these bills are similar to our recommendation, they differ in one important respect. All five of these bills would amend IRC § 6015(e) to add a new numbered paragraph providing that “[a]ny review of a determination under this section shall be reviewed *de novo* by the Tax Court.” This proposed language could be construed as conferring exclusive jurisdiction on the Tax Court to hear innocent spouse claims, which would preclude innocent spouse relief in collection, bankruptcy, and refund cases litigated in other federal courts and would be inconsistent with IRC § 6015(e)(1)(A) (conferring Tax Court jurisdiction “in addition to any other remedy provided by law”). It would also be inconsistent with the legislative recommendations, *Clarify that Taxpayers May Raise Innocent Spouse Relief As a Defense in Collection Proceedings and in Bankruptcy Cases*, *infra* and *Clarify that Taxpayers May Seek Innocent Spouse Relief in Refund Suits*, *infra*.

#53 CLARIFY THAT TAXPAYERS MAY RAISE INNOCENT SPOUSE RELIEF AS A DEFENSE IN COLLECTION PROCEEDINGS AND IN BANKRUPTCY CASES¹⁷⁶**Present Law**

Married taxpayers who file joint returns are jointly and severally liable for any deficiency or tax due. Spouses who live in community property states and file separate returns are generally required to report half of the community income on their separate returns. IRC §§ 6015 and 66, sometimes referred to as the “innocent spouse” rules, provide relief from joint and several liability and from the operation of community property rules. Taxpayers seeking innocent spouse relief generally file Form 8857, *Request for Innocent Spouse Relief*. After reviewing the request, the IRS issues a final notice of determination granting or denying relief in whole or in part.

If the taxpayer files a petition within 90 days from the date the IRS issues its final notice of determination, the United States Tax Court has jurisdiction to determine the appropriate relief. The Tax Court’s jurisdiction to decide innocent spouse claims does not appear to be exclusive; IRC § 6015(e)(1)(A) provides that an individual may petition the Tax Court for review of an innocent spouse determination “in addition to any other remedy provided by law.”

The Tax Court does not have jurisdiction over collection suits arising under IRC §§ 7402 or 7403 or over bankruptcy proceedings arising under Title 11 of the United States Code. Some federal courts with jurisdiction over these cases have considered taxpayers’ claims that they are entitled to innocent spouse relief, which is consistent with IRC § 6015(e)(1)(A).¹⁷⁷ Notwithstanding the language of IRC § 6015(e)(1)(A), however, some federal courts have held that the Tax Court’s jurisdiction to decide innocent spouse claims *is* exclusive and have declined to consider innocent spouse claims in these collection or bankruptcy cases.¹⁷⁸

Reasons for Change

Inconsistent decisions about whether taxpayers may raise innocent spouse relief as a defense in collection suits and bankruptcy proceedings have created confusion and have resulted in different treatment of similarly situated taxpayers. Moreover, the effect of treating the Tax Court as having exclusive jurisdiction over innocent spouse claims may be to create economic hardships. If the federal courts that decide collection suits and bankruptcy proceedings cannot consider innocent spouse claims, taxpayers in those cases may be left without any forum in which to seek innocent spouse relief before a court enters a financially damaging court judgment or, in rare cases, the taxpayer loses his or her home to foreclosure.

Legislation is needed to clarify that the statutory language of IRC § 6015 conferring Tax Court jurisdiction “in addition to any other remedy provided by law” does not give the Tax Court exclusive jurisdiction to

¹⁷⁶ Our recommendation that Congress clarify taxpayers may seek innocent spouse relief in collection proceedings and bankruptcy cases addresses issues similar to those discussed in our recommendation that Congress clarify taxpayers may seek innocent spouse relief in refund cases.

¹⁷⁷ See, e.g., *U.S. v. Diehl*, 460 F. Supp. 1282 (S.D. Tex. 1976), *aff’d per curiam*, 586 F.2d 1080 (5th Cir. 1978) (IRC § 7402 suit to reduce an assessment to judgment); and *In re Pendergraft*, 119 A.F.T.R.2d (RIA) 1229 (Bankr. S.D. Tex. 2017) (bankruptcy proceeding).

¹⁷⁸ *U.S. v. Boynton*, 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007) (IRC § 7402 suit to reduce an assessment to judgment); *U.S. v. Cawog*, 97 A.F.T.R.2d (RIA) 3069 (W.D. Pa. 2006), appeal dismissed (3d Cir. July 5, 2007) (IRC § 7403 suit to foreclose on federal tax liens); and *In re Mikels*, 524 B.R. 805 (Bankr. S.D. Ind. 2015) (bankruptcy proceeding).

determine innocent spouse claims and that U.S. District Courts and bankruptcy courts are also authorized to consider whether innocent spouse relief should be granted.¹⁷⁹

Recommendation

Amend IRC §§ 6015 and 66 to clarify that taxpayers are entitled to raise innocent spouse relief as a defense in a proceeding brought under any provision of Title 26 (including §§ 6213, 6320, 6330, 7402, and 7403) and in cases arising under Title 11 of the United States Code.

¹⁷⁹ Related to this recommendation, some proposed amendments to IRC § 6015 address the scope and standard of Tax Court review in innocent spouse cases. See, e.g., Taxpayer First Act, H.R. 5444, 115th Cong. § 11303 (2018) and Taxpayer First Act of 2018, S. 3246, 115th Cong. § 1003 (2018), proposing to add a new subsection to IRC § 6015(e) to provide that “[a]ny review of a determination under this section shall be reviewed de novo by the Tax Court.” The National Taxpayer Advocate agrees that the standard and scope of Tax Court review of innocent spouse cases should be *de novo*. However, the proposed amendments as written could be construed as conferring exclusive jurisdiction on the Tax Court to hear innocent spouse claims, which would be inconsistent with IRC § 6015(e)(1)(A). It would also be inconsistent with this recommendation relating to raising innocent spouse as a defense in collection suits and bankruptcy proceedings, and with the recommendation to *Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits, infra*. For this reason, the National Taxpayer Advocate recommends adding flush language about scope and standard of review to IRC § 6015(e)(A)(iii), thereby avoiding the inference that the Tax Court has exclusive jurisdiction over innocent spouse claims. See *Clarify that the Scope and Standard of Judicial Review of Determinations Under IRC § 6015 Are De Novo, supra*.

#54 CLARIFY THAT TAXPAYERS MAY SEEK INNOCENT SPOUSE RELIEF IN REFUND SUITS¹⁸⁰**Present Law**

IRC §§ 6015 and 66, sometimes referred to as the “innocent spouse” rules, provide relief from the joint and several liability that arises from filing a joint federal income tax return and from the operation of community property rules. Taxpayers may request that the IRS grant innocent spouse relief, and if a request is denied, they may seek judicial review.

United States Tax Court

Under IRC § 6015(e), the Tax Court has jurisdiction to review the IRS’s denial of a claim for innocent spouse relief and to determine the appropriate relief.

Until the Tax Court’s decision in a deficiency case becomes final, interest and penalties continue to accrue with respect to the entire unpaid liability, if any, ultimately determined to be owed. A taxpayer who obtains innocent spouse relief in Tax Court may be entitled to a refund to the extent permitted by IRC § 6015(g). Interest on any refund would be payable at the rate of three percentage points above the Federal short-term rate. A taxpayer may, without waiting for the outcome in Tax Court, stop the accrual of interest and penalties in a deficiency case by making a deposit under IRC § 6603, and if the taxpayer ultimately prevails in the Tax Court litigation, the deposit will be returned. However, interest will be paid at the Federal short-term rate.

There is no right to a jury trial in Tax Court.

Other Federal Courts

Taxpayers who pay a proposed deficiency and whose claims for tax refunds have been denied by the IRS cannot bring refund suits in the Tax Court, but they may seek refunds by filing suit in a United States District Court or in the U.S. Court of Federal Claims.

IRC § 6015(e) states that a taxpayer’s right to petition the Tax Court for innocent spouse relief is provided “[i]n addition to any other remedy provided by law.” Despite this language, a U.S. District Court recently concluded in the case of *Chandler v. United States* that it lacked jurisdiction to consider a taxpayer’s innocent spouse claim in a refund suit arising under IRC § 7422.¹⁸¹

A jury trial is available if a refund suit is brought in a U.S. District Court. If an individual taxpayer ultimately prevails in the refund suit, his or her payment will be refunded together with interest at the Federal short-term rate plus three percent.

¹⁸⁰ This recommendation that Congress clarify that taxpayers may seek innocent spouse relief in refund cases addresses issues similar to those discussed in our recommendation *Clarify that Taxpayers May Raise Innocent Spouse Relief as a Defense in Collection Proceedings and in Bankruptcy Cases*, *infra*.

¹⁸¹ *Chandler v. U.S.*, 2018 U.S. Dist. LEXIS 173880 (N.D. Tex. 2018) *adopting* 2018 U.S. Dist. LEXIS 174482 (N.D. Tex. 2018). The decision quoted *U.S. v. Elman*, 2012 U.S. Dist. LEXIS 173026 (N.D. Ill. 2012), which stated that “although the statute itself does not address whether the Tax Court’s jurisdiction is exclusive, courts interpreting the statute have concluded that it is.”

Reasons for Change

The *Chandler* decision is inconsistent with decisions by other federal courts that for decades have allowed taxpayers to seek innocent spouse relief in refund suits.¹⁸² The decision in *Chandler*, by foreclosing district court review of innocent spouse claims, leaves taxpayers with only one forum—the Tax Court—in which to seek review of an adverse IRS determination. Because there is no right to a jury trial in the Tax Court, the *Chandler* decision circumvents taxpayers’ right to have their cases decided by a jury. The *Chandler* decision also means that taxpayers who are willing to pay the asserted liability prior to litigation must forego three percentage points of interest. They cannot seek a refund in a district court (where any refund would be paid with interest at the Federal short-term rate plus three percentage points), but may make a deposit pending the outcome in the Tax Court (which would be repaid with interest at the short-term Federal rate).

Legislation is needed to clarify that the statutory language of IRC § 6015 conferring Tax Court jurisdiction “in addition to any other remedy provided by law” does not give the Tax Court exclusive jurisdiction to determine innocent spouse claims and that U.S. District Courts and the Court of Federal Claims are also authorized to consider whether innocent spouse relief should be granted in refund suits. Clarification will prevent further confusion as to whether seeking innocent spouse relief is allowable in those courts and will provide uniformity among all federal courts.¹⁸³

Recommendation

Amend IRC §§ 6015 and 66 to clarify that taxpayers are entitled to assert a claim for innocent spouse relief in refund suits arising under IRC § 7422.

¹⁸² See, e.g., *Sanders v. U.S.*, 509 F.2d 162 (5th Cir. 1975) *aff’d* 369 F. Supp. 160 (N.D. Ala. 1973); *Mlay v. IRS*, 168 F. Supp. 2d 781 (S.D. Ohio 2001); *Flores, v. U.S.*, 51 Fed. Cl. 49 (2001).

¹⁸³ Several recent bills would amend IRC § 6015 to address the scope and standard of Tax Court review in innocent spouse cases. See, e.g., Taxpayer First Act, H.R. 5444, 115th Cong. § 11303 (2018) and Taxpayer First Act of 2018, S. 3246, 115th Cong. § 1003 (2018), proposing to add a new subsection to IRC § 6015(e) to provide that “[a]ny review of a determination under this section shall be reviewed de novo by the Tax Court.” The National Taxpayer Advocate agrees that the standard and scope of Tax Court review of innocent spouse cases should be *de novo*. However, the proposed amendments as written could be construed as conferring exclusive jurisdiction on the Tax Court to hear innocent spouse claims, which would be inconsistent with IRC § 6015(e)(1)(A). They would also be inconsistent with this recommendation relating to seeking innocent spouse relief in refund suits and with the recommendation to *Clarify that Taxpayers May Raise Innocent Spouse Relief as a Defense in Collection Proceedings and in Bankruptcy Cases*, *supra*. For this reason, the National Taxpayer Advocate recommends adding flush language about scope and standard of review to IRC § 6015(e)(A)(iii), thereby avoiding the inference that the Tax Court has exclusive jurisdiction over innocent spouse claims. See *Clarify that the Scope and Standard of Judicial Review of Determinations Under IRC § 6015 is De Novo*, *supra*.

#55 FIX THE DONUT HOLE IN THE TAX COURT'S JURISDICTION TO DETERMINE OVERPAYMENTS BY NON-FILERS WITH FILING EXTENSIONS

Present Law

IRC § 6511(a) provides that the limitations period for filing a claim for refund generally expires two years after paying the tax or three years after filing the return, whichever is later. The amount a taxpayer can recover is limited to amounts paid within the applicable lookback period provided by IRC § 6511(b)(2). If a return is filed, then the lookback period is three years, plus any filing extension. Otherwise, the lookback period is two years. IRC § 6513(b) provides that withholding and other pre-payments are deemed paid on the due date of the return without regard to extensions. Thus, taxpayers who have overpaid on or before the original return filing deadline generally cannot claim a credit or refund more than two years later unless they file a return.

When a taxpayer does not file a return, the IRS sometimes sends a notice of deficiency to assess additional tax. A notice of deficiency gives the taxpayer the right to petition the Tax Court, and if the taxpayer timely does so, then the Tax Court generally has jurisdiction under IRC § 6512(b) to determine whether the taxpayer is due a refund for the taxable year at issue to the same extent the IRS could have considered a claim for refund filed on the date the IRS mailed the notice of deficiency. In the absence of a special rule, the Tax Court would have no jurisdiction to award refunds to non-filers who are issued a notice of deficiency after the two-year lookback period.

IRC § 6512(b)(3)(flush) provides such a special rule. It extends the limitations and lookback periods if the IRS mails a notice of deficiency *before* the taxpayer files a return. Specifically, it provides that if the IRS mails the notice of deficiency “during the third year after the due date (*with extensions*) for filing the return,” then the limitations and lookback periods are three years (not two), even though the taxpayer has not filed a return. Because the Tax Court’s general refund jurisdiction lapses after the second year following the original due date (*without regard to extensions*) and the special rule does not apply unless the IRS mails the notice after the second year (*with regard to extensions*), there is a six-month “donut hole” during which the IRS can send a notice of deficiency without triggering the Tax Court’s jurisdiction to consider the taxpayer’s claim for refund.

An example may help to illustrate these rules. Assume John Doe was over-withheld on April 15, 2016, the original filing deadline for a 2015 tax return. He requested a six-month extension of time to file, but did not get around to filing before July 1, 2018, when the IRS mailed him a notice of deficiency. He responded to the notice by petitioning the Tax Court to claim his refund. Under the general rule, Mr. Doe’s overpayment could only be refunded within two years of the due date of the return, *without regard to extensions* (*i.e.*, April 15, 2018). Thus, he can only recover his overpayment if the special rule extends this period.

The special rule only applies if the IRS mails the deficiency notice during the third year after the due date of his return (*with extensions*) (*i.e.*, the year beginning after October 15, 2018). Because the IRS mailed his deficiency notice before the beginning of the third year, the special rule does not apply, and Mr. Doe cannot get his refund.

Reasons for Change

According to H.R. Rep. No. 105-220, at 701 (1997) (Conf. Rep.), Congress enacted the special rule of IRC § 6512(b)(3)(flush) to put non-filers who receive notices of deficiency after the two-year lookback period on the same footing as taxpayers who file returns on the same day the IRS mailed the notice of deficiency. It was supposed to allow non-filers “who receive a notice of deficiency and file suit to contest it in Tax Court

during the third year after the return due date, to obtain a refund of excessive amounts paid within the 3-year period prior to the date of the deficiency notice.”

However, the statute as written does not fully fix the problem it was enacted to solve. In *Borenstein*, the Tax Court concluded that it had no jurisdiction to determine a non-filer’s overpayment because the non-filer had requested a six-month extension to file and the IRS mailed the notice of deficiency during the first six months of the third year following the original due date—*after* the second year following the due date (without extensions) and *before* the third year following the due date (*with extensions*).¹⁸⁴ Thus, the court found that the special rule of IRC § 6512(b)(3)(flush) leaves a donut hole in its jurisdiction.

Although this problem only affects the relatively limited number of taxpayers who request a six-month filing extension and then, for whatever reason, do not file a return, Congress felt it was important to provide them with this special rule. For that reason, we believe it is important to highlight this unintended result and recommend a solution.

Recommendation¹⁸⁵

Amend IRC § 6512(b)(3) to clarify that when the IRS mails a notice of deficiency to a non-filer after the second year following the due date of the return (*without regard to extensions*), the limitations and lookback periods for filing a claim for refund or credit are at least three years from the due date of the return (*without regard to extensions*).

¹⁸⁴ *Borenstein v. Comm’r*, 149 T.C. No. 10 (2017), *appeal docketed*, No. 17-390 (2d Cir. Dec. 4, 2017). Although the *Borenstein* case is being appealed, the Tax Court would not have to follow a taxpayer-favorable Second Circuit decision in cases arising in other circuits. Thus, unless the Tax Court revisits its decision, a legislative fix is needed.

¹⁸⁵ For more detail, see National Taxpayer Advocate 2018 Annual Report to Congress (Legislative Recommendation: *Fix the Donut Hole in the Tax Court’s Jurisdiction to Determine Overpayments by Non-filers with Filing Extensions*).