

Strengthen Taxpayer Rights in Judicial Proceedings

#45 AUTHORIZE THE TAX COURT TO ORDER REFUNDS OR CREDITS IN COLLECTION DUE PROCESS PROCEEDINGS

Present Law

Internal Revenue Code (IRC) § 6512(b) grants the Tax Court jurisdiction in deficiency suits to determine that a taxpayer made an overpayment of income tax for the period at issue and that such amount must be refunded or credited to the taxpayer.¹⁶⁸ IRC § 6511(a) generally requires a taxpayer to file a claim for credit or refund by the later of three years from the time a return was filed, or if no return was filed, two years from the time the tax was paid.

IRC § 6330 allows a taxpayer in certain instances to challenge the underlying liability in a Collection Due Process (CDP) proceeding. Unlike in deficiency cases, however, it does not grant the Tax Court jurisdiction to determine the extent to which a taxpayer has made an overpayment and is entitled to a refund or credit.¹⁶⁹ For a taxpayer in a CDP proceeding to receive a refund, the taxpayer must first fully pay the assessed tax for the taxable year(s) at issue, file a timely administrative refund claim with the IRS under IRC § 6511, and if the claim is denied, timely file a refund suit in a U.S. district court or the Court of Federal Claims.

Reasons for Change

The limitation on the Tax Court's jurisdiction to determine an overpayment and order a refund in CDP cases prevents taxpayers from obtaining resolution of their tax disputes in one forum and imposes unnecessary financial and administrative burdens on taxpayers and the court system. The Tax Court, unlike other federal courts, is a pre-payment forum that ordinarily allows taxpayers to dispute their liabilities without having to first full-pay them. In a CDP proceeding, only taxpayers who did not otherwise have an opportunity to dispute their underlying liability are permitted to contest it.

CDP taxpayers who may challenge the existence or amount of the underlying tax liability pursuant to IRC § 6330(c)(2)(B) should, similar to taxpayers in deficiency proceedings, have the opportunity to obtain a refund in a pre-payment forum, rather than be required to full-pay the liability and then incur additional time and expense to dispute the liability in another forum. A taxpayer disputing the underlying liability in a CDP case is subject to limitations similar to those that apply to taxpayers in deficiency proceedings. The court reviews the amount of the tax liability on a *de novo* basis,¹⁷⁰ and the scope of its review extends to evidence introduced at the trial that was not a part of the administrative record.¹⁷¹ Amending IRC § 6330 to explicitly grant the Tax Court the authority to determine overpayments and issue refunds in CDP cases will protect taxpayers' *right to finality*, reduce taxpayer burden, and better ensure the IRS collects the correct amount

¹⁶⁸ IRC § 6401 provides that the term "overpayment" includes "that part of the amount of the payment of any internal revenue tax which is assessed or collected after the expiration of the period of limitation properly applicable thereto." The Supreme Court has stated that an overpayment occurs "when a taxpayer pays more than is owed, for whatever reason or no reason at all." *United States v. Dalm*, 494 U.S. 596, 609 n. 6 (1990). See also *Jones v. Liberty Glass Co.*, 332 U.S. 524, 531 (1947).

¹⁶⁹ See *Greene-Thapedi v. Comm'r*, 126 T.C. 1 (2006); *Willson v. Comm'r*, 805 F.3d 316 (D.C. Cir. 2015); *McLane v. Comm'r*, T.C. Memo. 2018-149 (2018).

¹⁷⁰ Under a *de novo* standard of review, the Tax Court will consider all relevant evidence introduced at trial. *Jordan v. Comm'r*, 134 T.C. 1, 8 (2010).

¹⁷¹ The legislative history of RRA 98 addresses the standard of review courts should apply in reviewing Appeals' CDP determinations. H.R. REP. NO. 105-599, at 266 (1998). See also IRS Chief Counsel Notice CC-2014-002, Proper Standard of Review for Collection Due Process Determinations (May 5, 2014).

of tax. Furthermore, the Tax Court could apply to CDP proceedings its long-established procedures for determining an overpayment in deficiency cases.

Refund claims in CDP cases should be subject to the limitations of IRC §§ 6511(a) and 6512(b)(3). If the claim was filed by the taxpayer within three years from the time a return was filed, the amount of the refund would be limited to the amount paid in the three-year period (plus extensions) before the notice of deficiency was mailed and the amount paid after the notice of deficiency was mailed.

Recommendation

- Amend IRC § 6330(d)(1) to grant the Tax Court jurisdiction to determine overpayments for the tax periods at issue and to order refunds or credits, subject to the limitations of IRC §§ 6511(a) and 6512(b)(3), if the court determines the amount of the taxpayer's underlying tax liability for a taxable year is less than the amounts paid or credited for that year.

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

Present Law

Internal Revenue Code (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.

A taxpayer may sue in a U.S. District Court or the U.S. Court of Federal Claims under 28 U.S.C. § 1346(a)(1) 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.¹⁷²

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 do so unless resolution of the dispute would benefit the taxpayer’s other creditors.

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 an IRS decision in an independent forum*.

¹⁷² To be timely, IRC § 6511(a) generally requires that an administrative claim must be filed within the later of (i) three years from the date the original return was filed or (ii) two years from the date 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.

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 or her alleged debt within two years will lose the right to request a refund of the early payments, even if he or she eventually pays in full and the court agrees with him or her on the merits of the refund claim.

Even when the IRS sends a 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.

Although the Supreme Court once feared that giving the relatively few wealthy persons who were subject to tax the option to litigate rather than pay could threaten the solvency of the government, the U.S. tax base is much broader today, and as a result, whether judicial review occurs before or after payment in individual cases is not nearly as important to the government as it once was. Moreover, since the *Flora* case was decided in 1960, the problems created by the full payment rule have grown. In 1960, there were only four assessable penalties. Today, there are more than 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 their ability to pay.

Recommendations¹⁷³

While a simple solution might be to repeal the full payment rule, Congress should also consider one or more of the following options:¹⁷⁴

- 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.
- 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

173 For more detail, see National Taxpayer Advocate 2018 Annual Report to Congress 364 (Legislative Recommendation: *Fix the Flora Rule: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*).

174 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).

account as currently not collectible due to economic hardship or (b) the taxpayer has entered into an agreement to pay the liability in installments.¹⁷⁵

- 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.

¹⁷⁵ As noted above, a similar rule applies to estates that elect to pay in installments. See IRC § 7422(j).

#47 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 Internal Revenue Code (IRC) authorize proceedings or suits against the government, provided such actions are brought timely. These actions are generally brought in the U.S. Tax Court, a U.S. District Court, or the U.S. Court of Federal Claims.¹⁷⁶

Equitable doctrines that, 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).

U.S. Tax Court

For some types of tax controversies, the U.S. 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 “standalone” 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.

In the absence of a timely filed petition, however, the Tax Court has held it does not have jurisdiction to redetermine deficiencies, hear appeals from IRS CDP proceedings, consider standalone innocent spouse claims, or decide whistleblower claims.

With respect to deficiency cases and standalone innocent spouse cases, several U.S. Courts of Appeal 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. In addition, one appellate court agreed with the Tax Court that the deadline for filing a petition in a CDP case is not subject to equitable tolling.¹⁷⁷ However, a different appellate court, interpreting language in IRC § 7432 (the whistleblower statute) that is “nearly

¹⁷⁶ Some tax claims may also be heard by U.S. bankruptcy courts. For a fuller discussion of this recommendation, see National Taxpayer Advocate 2017 Annual Report to Congress 283 (Legislative Recommendation: *Equitable Doctrines: 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*).

¹⁷⁷ *Duggan v. Comm’r*, 879 F.3d 1029, 1034 (9th Cir. 2018).

identical in structure” to the language in IRC § 6330 (the CDP statute), reversed a Tax Court dismissal and held that the filing deadline for whistleblower cases is not jurisdictional and is subject to equitable tolling.¹⁷⁸

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 U.S. District Courts or in the U.S. Court of Federal Claims within two years after the IRS denies the claim. There is a split between circuits regarding whether the statutory period for seeking refunds is subject to equitable doctrines.¹⁷⁹

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,¹⁸⁰ but at least one appellate court has held that it is.¹⁸¹

Taxpayers may also bring suit, if they do so within the specified periods, to seek civil damages in a U.S. 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.¹⁸²

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.¹⁸³

178 *Myers v. Comm’r*, 928 F.3d 1025, 1036 (D.C. Cir. 2019), *reh’g en banc denied*, No. 18-1003 (D.C. Cir. Oct. 4, 2019). At least one other taxpayer, relying on the *Myers* decision, has argued that the CDP deadlines are not jurisdictional (see Opening Brief of Petitioner-Appellant, *Boechler v. Comm’r*, Docket No. 19-2003, 2019 WL 3384248 (8th Cir. 2019)).

179 *Compare RHI Holdings, Inc. v. United States*, 142 F.3d 1459, 1460-1463 (Fed. Cir. 1998) (declining to apply equitable principles to IRC § 6352) with *Wagner v. United States*, 2018-2 U.S.T.C. (CCH) ¶150,496 (E.D. Wash. 2018) (the time limits set forth in IRC § 6352 are not jurisdictional; furthermore, plaintiff’s petition was timely filed) and *Howard Bank v. United States*, 759 F. Supp. 1073, 1080 (D. Vt. 1991), *aff’d*, 948 F.2d 1275 (2d Cir. 1991) (applying equitable principles to IRC § 6352 and estopping the IRS from raising the limitations period as a bar to suit).

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

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

182 *Compare Aloe Vera of America, Inc. v. United States*, 580 F.3d 867, 871-872 (9th Cir. 2009) (time for bringing suit under IRC § 7431 is not subject to equitable tolling) with *United States v. Marsh*, 89 F. Supp. 2d 1171, 1177 (D. Haw. 2000) (doctrine of equitable tolling is an extraordinary remedy that did not apply in an IRC § 7433 action), *Ramos v. United States*, 2002-2 U.S.T.C. (CCH) ¶150,767 (N.D. Cal. 2002) (denying motion to dismiss because doctrine of equitable tolling might apply to an IRC § 7433 action), and *Bennett v. United States*, 366 F. Supp. 2d 877, 879 (D. Neb. 2005) (whether equitable tolling applies to IRC §§ 7432 and 7433 actions has not been definitively determined, but it is an extraordinary remedy and did not apply in this case).

183 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).

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.

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.¹⁸⁴

¹⁸⁴ 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.

#48 PROVIDE THAT THE SCOPE OF JUDICIAL REVIEW OF DETERMINATIONS UNDER IRC § 6015 IS *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. Internal Revenue Code (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, or a request for relief has gone unanswered for six months, 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.¹⁸⁵ 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 IRS’s determination.¹⁸⁶

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.¹⁸⁷ 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 are not *de novo*.¹⁸⁸ 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 would 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.¹⁸⁹

In 2019, Congress added paragraph (7) to IRC § 6015(e). It provides that “any review of a determination made under this section is *de novo* by the Tax Court.”¹⁹⁰ However, this *de novo* review is limited to consideration of “(A) the administrative record established at the time of the determination, and (B) any

¹⁸⁵ *Porter v. Comm’r*, 130 T.C. 115 (2008).

¹⁸⁶ *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).

¹⁸⁷ 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).

¹⁸⁸ Notice CC-2013-011, Litigating Cases That Involve Claims for Relief from Joint and Several Liability Under Section 6015 (June 7, 2013).

¹⁸⁹ 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 issue addressed in the AOD.

¹⁹⁰ Taxpayer First Act, Pub. L. No. 116-25, § 1203, 133 Stat. 981 (2019).

additional newly discovered or previously unavailable evidence.” The provision does not define the terms “newly discovered” or “previously unavailable.”

Reasons for Change

IRC § 6015(e)(7), which limits the Tax Court’s scope of review, applies to determinations made “under this section” (*i.e.*, IRC § 6015). Thus, the provision supersedes Tax Court jurisprudence with respect to the scope of review not only in IRC § 6015(f) cases, but also in IRC § 6015 (b) and (c) cases.

The provision may be intended to encourage the IRS and taxpayers to compile a complete administrative record or resolve cases without litigation. In some cases, however, taxpayers — and particularly taxpayers not represented by counsel — may not appreciate the significance of certain evidence or the consequences of failing to present it to the IRS. In other cases, taxpayers may be willing to present relevant evidence during trial to a neutral third party — the judge — that they are reluctant to share with the IRS, such as evidence of the other joint filer’s domestic violence or abuse.¹⁹¹

Moreover, some taxpayers could be deprived of meaningful Tax Court review — particularly taxpayers who filed Tax Court petitions when their requests for relief went unanswered for six months — because the administrative record may consist of little more than the taxpayer’s skeletal responses to the information solicited by Form 8857, Request for Innocent Spouse Relief, and the IRS may argue that the taxpayer’s evidence is not “newly discovered” or “previously unavailable.”¹⁹² If the court accepts the IRS’s argument that under IRC § 6015(e)(7) the taxpayer’s evidence should not be considered because it was available but not presented at the time of the IRS’s determination, the court may decide the case *de novo* on the basis of the scant evidence contained in the administrative record.¹⁹³ To enable the Tax Court to make the correct decision based on the merits of the case, the National Taxpayer Advocate believes the court should be permitted to consider all relevant evidence, whether or not it could have been provided to the IRS in a prior administrative proceeding.

Finally, some taxpayers who wish to obtain review by a federal court that is *de novo* in scope may choose to pay the asserted tax and bring a refund suit before a U.S. district court or the U.S. Court of Federal Claims. But this approach carries the risk that these courts may conclude they lack jurisdiction to hear innocent spouse claims.¹⁹⁴ To address these cases, the National Taxpayer Advocate recommends the statute be amended to allow courts to consider all relevant evidence in IRC § 6015 cases.

191 Abuse that prevented a taxpayer from challenging the treatment of an item on the joint return out of fear the other spouse might retaliate would weigh in favor of granting relief. *Stephenson v. Comm’r*, T.C. Memo. 2011-16, is an example of a case in which the Tax Court’s finding that the petitioner was physically and verbally abused by her husband was largely based on evidence produced at trial because the issue of abuse was not fully developed administratively.

192 Chief Counsel has not yet issued guidance to its attorneys about what arguments to make in cases in which IRC § 6015(e)(7) may apply.

193 Where the IRS did not answer the taxpayer’s request for relief for more than six months, the court may remand the case and direct the IRS to do so, which may prolong resolution of the case.

194 The National Taxpayer Advocate recommends that Congress address this risk. See *Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits*, *infra*.

Recommendation

- Remove IRC § 6015(e)(7)(A) and (B) and revise IRC § 6015(e)(7) to provide: “The standard and scope of any review of a determination made under this section by the Tax Court or other court of competent jurisdiction shall be *de novo*.”¹⁹⁵

¹⁹⁵ This recommendation averts the possibility that the language in IRC § 6015(e)(7) that “[a]ny review of a determination under this section shall be reviewed *de novo* by the Tax Court” 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”). Such an interpretation 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*.

#49 CLARIFY THAT TAXPAYERS MAY RAISE INNOCENT SPOUSE RELIEF AS A DEFENSE IN COLLECTION PROCEEDINGS AND IN BANKRUPTCY CASES¹⁹⁶

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 the community income on their separate returns. Internal Revenue Code (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 a 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.”

However, the scope of the Tax Court’s review is not *de novo*, but is limited to “(A) the administrative record established at the time of the determination, and (B) any additional newly discovered or previously unavailable evidence.”¹⁹⁷

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’ innocent spouse claims and determined that they are entitled to innocent spouse relief, which is consistent with IRC § 6015(e)(1)(A).¹⁹⁸ These courts have not limited the scope of their consideration of the innocent spouse claim.

However, other federal courts have held that the Tax Court’s jurisdiction to decide innocent spouse claims is exclusive and have declined to consider such claims in collection or bankruptcy cases.¹⁹⁹

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 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 create economic hardships. If the federal courts that decide collection suits and bankruptcy

¹⁹⁶ 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.

¹⁹⁷ IRC § 6015(e)(7). This provision was enacted by the Taxpayer First Act, Pub. L. No. 116-25, § 1203, 133 Stat. 981 (2019). The National Taxpayer Advocate recommends revising IRC § 6015(e)(7) to remove this limitation on the Tax Court’s scope of review. See *Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is De Novo*, *supra*.

¹⁹⁸ See, e.g., *United States 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); *In re Pendergraft*, 119 A.F.T.R.2d (RIA) 1229 (Bankr. S.D. Tex. 2017) (bankruptcy proceeding).

¹⁹⁹ *United States v. Boynton*, 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007) (IRC § 7402 suit to reduce an assessment to judgment); *United States v. Cawog*, 97 A.F.T.R.2d (RIA) 3069 (W.D. Pa. 2006), *appeal dismissed* (3d Cir. 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).

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 judgment or, in rare cases, the taxpayer loses his or her home to foreclosure. In some cases, taxpayers who are forced to raise their innocent spouse claims in Tax Court will be deprived of a *de novo* scope of review that would be available in other federal courts.

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 bankruptcy courts are also authorized to consider whether innocent spouse relief should be granted.²⁰⁰

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.

²⁰⁰ Related to this recommendation, the Taxpayer First Act, Pub. L. No. 116-25, § 1203, 133 Stat. 981 (2019) added subsection (7) to IRC § 6015(e), which provides 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 new provision 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). Such an interpretation 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 clarifying that the scope and standard of review are *de novo* in innocent spouse cases adjudicated by the Tax Court “or other court of competent jurisdiction,” thereby avoiding the inference that the Tax Court has exclusive jurisdiction over innocent spouse claims. See *Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is De Novo, supra*.

#50 CLARIFY THAT TAXPAYERS MAY SEEK INNOCENT SPOUSE RELIEF IN REFUND SUITS²⁰¹**Present Law**

Internal Revenue Code (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. There is no right to a jury trial in Tax Court, and the scope of the Tax Court’s review of a denial of a claim for innocent spouse relief under IRC § 6015 is limited to “(A) the administrative record established at the time of the determination, and (B) any additional newly discovered or previously unavailable evidence.”²⁰²

Other Federal Courts

Taxpayers who pay a proposed deficiency before filing a Tax Court petition and whose administrative 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 U.S. 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 the quoted 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 § 7422.²⁰³

A jury trial is available if a refund suit is brought in a U.S. District Court, and the scope of the court’s review in a refund suit is *de novo* (*i.e.*, not limited, for example, to the administrative record).²⁰⁴

201 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*, *supra*.

202 IRC § 6015(e)(7). This provision was enacted as part of the Taxpayer First Act, Pub. L. No. 116-25, § 1203, 133 Stat. 981 (2019). The National Taxpayer Advocate recommends revising IRC § 6015(e)(7) to remove this limitation on the Tax Court’s scope of review. See *Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is De Novo*, *supra*.

203 *Chandler v. United States*, 2018 U.S. Dist. LEXIS 173880 (N.D. Tex. 2018) *adopting* 2018 U.S. Dist. LEXIS 174482 (N.D. Tex. 2018). The decision quoted *United States v. Elman*, 2012 U.S. Dist. LEXIS 173026, at *8 (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.”

204 See *Vons Companies v. United States*, 51 Fed. Cl. 1, 5-6 (2001), noting “the axiomatic principle that tax refund cases are *de novo* proceedings” in which the court’s determination of the taxpayer’s tax liability is “based upon the facts and merits presented to the court and does not require (or even ordinarily permit) this court to review findings or a record previously developed at the administrative level.” (citations omitted).

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.²⁰⁵ 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. Taxpayers are thus deprived of judicial review of their cases that is *de novo* in scope. Because there is no right to a jury trial in the Tax Court, the *Chandler* decision also undermines taxpayers' right to have their cases decided by a jury.

Moreover, a refund suit may involve issues other than innocent spouse relief over which the court would clearly have jurisdiction. Requiring taxpayers to litigate the innocent spouse claim in Tax Court and other issues in a different federal court imposes an unreasonable burden on taxpayers and undermines judicial economy.

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 U.S. 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.²⁰⁶

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.

²⁰⁵ See, e.g., *Sanders v. United States*, 509 F.2d 162 (5th Cir. 1975) *aff'g* 369 F. Supp. 160 (N.D. Ala. 1973); *Mlay v. IRS*, 168 F. Supp. 2d 781 (S.D. Ohio 2001); *Flores v. United States*, 51 Fed. Cl. 49 (2001); and *Hockin v. United States*, 2019 U.S. Dist. LEXIS 137972, at *15 n. 2 (D. Or. 2019), in which the court distinguished the *Chandler* case, observing that “notably the plaintiff [in the *Chandler* case] did not respond to the motion to dismiss, so that district court was deprived of the benefit of reasoned argument on the issue from both parties.”

²⁰⁶ Related to this recommendation, the Taxpayer First Act, Pub. L. No. 116-25, § 1203, 133 Stat. 981 (2019) added subsection (7) to IRC § 6015(e), providing 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 new provision 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). Such an interpretation 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 clarifying that the scope and standard of review are *de novo* in innocent spouse cases before the Tax Court “or other court of competent jurisdiction,” thereby precluding any implication that the Tax Court has exclusive jurisdiction over innocent spouse claims. See *Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is De Novo*, *supra*.

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

Present Law

Internal Revenue Code (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. The special rule 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 may 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*).²⁰⁷ Thus, the court found that the special rule of IRC § 6512(b)(3)(flush) leaves a donut hole in its jurisdiction. Although the U.S. Court of Appeals for the Second Circuit reversed the Tax Court’s decision in this case, the Tax Court is not required to follow the Second Circuit’s decision in cases arising in other circuits.²⁰⁸ Thus, unless the Tax Court revisits its decision, a legislative fix is still needed.

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.

Recommendation²⁰⁹

- 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*).

²⁰⁷ *Borenstein v. Comm’r*, 149 T.C. 263 (2017), *rev’d*, 919 F.3d 746 (2d Cir. 2019).

²⁰⁸ *Golsen v. Comm’r*, 54 T.C. 742, 757 (1970), *aff’d*, 445 F.2d 985 (10th Cir. 1971).

²⁰⁹ For more detail, see National Taxpayer Advocate 2018 Annual Report to Congress (Legislative Recommendation: *Tax Court Jurisdiction: Fix the Donut Hole in the Tax Court’s Jurisdiction to Determine Overpayments by Non-Filers With Filing Extensions*); National Taxpayer Advocate, *The Second Circuit in Borenstein Helped to Close the Gap in the Tax Court’s Refund Jurisdiction, but Only for Taxpayers in that Circuit*, NTA Blog (Apr. 27, 2019), <https://taxpayeradvocate.irs.gov/news/nta-blog-the-second-circuit-in-borenstein-helped-to-close-the-gap-in-the-tax-court-s-refund-jurisdiction-but-only-for-taxpayers-in-that-circuit>.