LR #3 FIX THE FLORA RULE: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

PROBLEM

In 1958 in *Flora I* and again in 1960 in *Flora II,* the U.S. Supreme Court held that taxpayers must fully pay a tax liability before filing a refund suit in a district court or the U.S. Court of Federal Claims (as summarized in the Appendix).[2] The Court reasoned that this full payment rule (a.k.a. the *Flora* rule) would protect the "public purse" and cited its decision in *Cheatham* that justified the rule as necessary to protect the very "existence of government."[3] In 1875 when *Cheatham* was decided, the rule may have been necessary to prevent local courts from starving the young federal government of the revenue it needed to exist. Today, the full payment rule is no longer needed to protect the existence of the government and may not even protect the public purse.

It is clear, however, that the full payment rule gives the poor who cannot pay a disputed liability less access to judicial review than wealthier taxpayers who can. Because the IRS may assess certain penalties (called "assessable penalties") before giving the taxpayer an opportunity to petition the Tax Court to review them, the rule also closes the courthouse door to those facing assessable penalties that are too large to pay—precisely the penalties that are most damaging if they are wrongly assessed.[4] Even if the IRS's liability determination is correct, a lack of due process seems unfair and may erode voluntary

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 See *Flora v. United States (Flora I)*, 357 U.S. 63 (1958), *reaff'd*, *Flora v. United States (Flora II)*, 362 U.S. 145 (1960). *Flora II* was a 5-4 decision with the majority acknowledging that "as we recognized in the prior opinion, the statutory language is not absolutely controlling." *Flora II*, 362 U.S. at 151.

3 See *Flora I*, 357 U.S. at 67-69 (*citing Cheatham v. United States*, 92 U.S. 85, 89 (1875), which said the very "existence of government" was at stake); *Flora II*, 362 U.S. at 175 ("the Government has a substantial interest in protecting the public purse, an interest which would be substantially impaired if a taxpayer could sue in a District Court without paying his tax in full"). For a discussion of how Congress has increasingly provided taxpayers with procedural protections, overriding the sovereign's ancient power to require immediate payment of taxes, see Nina E. Olson, 2010 Erwin N. Griswold Lecture Before the American College of Tax Counsel, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 63 Tax Law. 227 (2010).

4 See IRC §§ 6671(a), 6212, and 6213.

compliance—a consequence which may pose a greater risk to the public purse than providing a pre-payment forum for judicial review.[5]

Moreover, the problems posed by assessable penalties have grown. When *Flora I* was decided, there were only four assessable penalties, but today there are over 50.[6] This erosion of judicial oversight is particularly inconsistent with the taxpayer's *right to appeal an IRS decision in an independent forum* and *right to a fair and just tax system.*

EXAMPLES

Example 1: The District Court and the Court of Federal Claims Cannot Review Claims from Those Who Cannot Fully Pay

In 2010, the IRS audited Ms. Jane Doe's 2007 income tax return and issued a notice of deficiency, proposing to disallow her Earned Income Tax Credit (EITC) because she had no bank account or accounting system to substantiate her earned income.[7] If given an opportunity, Ms. Doe could substantiate her income in court using the testimony of customers. Because she did not understand the notice of deficiency, Ms. Doe missed the deadline for filing a petition with the Tax Court.[8] Under the full payment rule, she cannot file suit in a district court or in the Court of Federal Claims before paying in full. Because she cannot afford to pay in full, she cannot get her case reviewed, and the IRS will attempt to collect the inaccurate deficiency.

Example 2: By the Time a Person Has Fully Paid in Installments, It May Be Too Late to Recover the Early Payments

The facts are the same as in Example 1, except that Ms. Doe entered into an installment agreement (IA) to pay the liability over a six-year period (*i.e.*, between 2010 and 2016).[9] Neither the applicable U.S. District Court nor the U.S. Court of Federal Claims had jurisdiction to review her case before she completed the IA and fully paid. After completing the IA and fully paying the liability in 2016, Ms. Doe filed a claim for refund. By 2016, she could only recover the portions she paid in the last two

5 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-28 (finding that trust and norms correlate with estimated tax compliance among Schedule C filers). Indeed, *Flora II* suggested that the full payment rule would promote voluntary compliance, in part, because enforced collection of a disputed liability while a case was before a district court or the Court of Federal Claims would adversely affect voluntary compliance. *Flora II* at 176 n. 43. This suggestion by *Flora II* seems to assume that the full payment rule simply shifts litigation from proceedings that do not suspend collection to the Tax Court where enforced collection is suspended. Today, however, the rule empowers the IRS to collect liabilities that are not subject to judicial review.

6 *Compare* Internal Revenue Code of 1954, Pub. L. No. 83-591, 68 Stat. 730 (1954) (reflecting three assessable penalties, codified at IRC §§ 6672-6674), *as amended by* Pub. L. No. 84-466, § 3, 70 Stat. 90 (1956) (enacting a fourth, codified at IRC § 6675), *with* IRC §§ 6671-6725 (more than 50 present-day assessable penalties).

7 This hypothetical example was inspired by a recent case. *See Lopez v. Comm'r*, T.C. Summ. Op. 2017-16 (holding an unbanked taxpayer who timely petitioned the Tax Court was entitled to EITC because she substantiated her earned income in court based on the testimony of customers).

8 Low income taxpayers can easily miss filing deadlines. *See, e.g., Mullins v. IRS*, 120 A.F.T.R.2d (RIA) 5028 (S.D. Ohio 2017) (considering an EITC claim in district court after the taxpayer missed the deadline for filing a petition with the Tax Court and paid the assessment). For example, the notice could be sent to an old address or taken by a roommate. Some taxpayers may be afraid to open a letter from the IRS. Some may not understand the IRS's letters (*e.g.*, due to literacy or language barriers). Others may mistakenly write to the IRS instead of filing a petition with the Tax Court.

9 This hypothetical example was inspired by the dissent in *Flora II*. *See Flora II*, 362 U.S. at 195-96 (J. Whittaker, dissenting) (warning that early installment payments would not be reviewable under the full payment rule). The same result could occur if instead of entering an installment agreement (IA), the IRS simply offset the taxpayer's refunds each year for six years.

years (*i.e.*, 2015 and 2016).[10] Because the full payment rule delayed her suit, it was too late to recover the payments she made during 2010-2014.[11]

Example 3: Collection Due Process Appeals Jurisdiction Does Not Solve the Problem

The facts are the same as in Example 1, except that after the IRS assessed the deficiency it filed a notice of federal tax lien (NFTL) and sent Ms. Doe a Collection Due Process (CDP) notice.[12] Ms. Doe requested a CDP hearing with the IRS's Appeals function. Appeals could not consider Ms. Doe's underlying liability at the hearing because she had received a statutory notice of deficiency.[13] Although the Tax Court has jurisdiction to review the results of a CDP hearing, it does not have jurisdiction to consider issues not properly raised and considered in the hearing.[14] Thus, it could not review the disputed liability. In addition, Ms. Doe cannot file suit in a district court or in the Court of Federal Claims because she has not fully paid the liability.

Example 4: Assessable Penalties That Are Too Large to Pay Are Not Subject to Judicial Review

An examiner erroneously proposed over $160 million in penalties against Mr. John Doe under IRC § 6707 for failure to timely register a tax shelter.[15] The IRS Office of Appeals reduced the penalty to about $65 million, which Mr. Doe still could not pay. Because IRC § 6707 is an assessable penalty, the IRS properly assessed it without sending him a notice of deficiency. A notice of deficiency would have given him the right to petition the Tax Court.[16] Because Mr. Doe cannot pay the assessment, neither a district court nor the Court of Federal Claims has jurisdiction to review it under the full payment rule. Because he was given the opportunity for an administrative appeal, the Tax Court would not have jurisdiction to review the liability in connection with a CDP hearing.[17]

10 A taxpayer must make an administrative claim for refund before filing suit. IRC § 7422(a). In general, any administrative claim must be made within the later of three years after the filing of the original tax return or two years of payment of the tax. IRC § 6511(a). If the claim is filed in the two-year period, the amount that can be refunded is generally limited to taxes paid within the two-year period before the claim is made. IRC § 6511(b)(2)(B).

11 We do not propose to extend the limitations period because there are good reasons for them. It makes more sense to allow a court to determine how much a person owes as quickly as possible. By the time a taxpayer has paid, witnesses are less likely to be available, memories are more likely to have faded, and relevant documentation is more likely to have been lost. For further discussion of the benefits of limitations periods, see, *e.g.*, National Taxpayer Advocate 2009 Annual Report to Congress 391-399 (Legislative Recommendation: *Provide a Fixed Statute of Limitations for U.S. Virgin Islands Taxpayers*).

12 The IRS must send a collection due process (CDP) notice after filing a Notice of Federal Tax Lien (NFTL) and before issuing a levy. *See generally*, IRC §§ 6320 (lien), 6330 (levy).

13 IRC § 6330(c)(2)(B); IRC § 6320(c). *See also* IRM 8.22.8.3 (Aug. 9, 2017).

14 *See* IRC § 6330(d)(1); Treas. Reg. §§ 301.6320-1(f)(2) Q&A F3, 301.6330-1(f)(2) Q&A F3.

15 This hypothetical example was loosely inspired by *Larson v. United States*, 888 F.3d 578 (2d Cir. 2018), *aff'g* 118 A.F.T.R.2d (RIA) 7004 (S.D.N.Y. 2016) (district court had no jurisdiction to review of assessable penalties under IRC § 6707). However, the example assumes the penalties were erroneously assessed.

16 IRC §§ 6212, 6213.

17 IRC § 6330(c)(2)(B); IRC § 6320(c); Treas. Reg. §§ 301.6320-1(e)(3)A-E2 and 301.6330–1(e)(3)A–E2. These regulations are controversial, as discussed in footnote 32, below.

RECOMMENDATIONS

A simple solution would be to repeal the full payment rule.[18] If Congress prefers a more tailored approach to improve access to judicial review, the National Taxpayer Advocate recommends Congress:

1. Amend 28 U.S.C. § 1346(a)(1) to clarify that full payment of a disputed amount is only a prerequisite for jurisdiction by district courts and the U.S. Court of Federal Claims if the taxpayer has received a notice of deficiency. If enacted, taxpayers who are subject to assessable penalties would not need to pay them in full before filing suit in a district court or the Court of Federal Claims.
2. Amend 28 U.S.C. § 1346(a)(1) to clarify that a taxpayer is treated as having fully paid a disputed amount for purposes of the full payment rule at the earlier of when the taxpayer has paid some of it (including by offset) and either (a) the IRS has classified the account as currently not collectible due to economic hardship,[19] or (b) the taxpayer has entered into an agreement to pay the liability in installments.[20] If enacted, taxpayers who cannot afford to pay would have the same access to judicial review as those who can (*i.e.*, the option to file suit in a district court or the U.S. Court of Federal Claims).
3. Amend IRC § 6214 to authorize the U.S. Tax Court to review liabilities where the taxpayer has not received a notice of deficiency (*e.g.,* assessable penalties) in a manner that parallels the deficiency process. In addition, allow the IRS to assess and collect liabilities only after any such review is complete or the period for filing a Tax Court petition has expired. Alternatively, Congress could expand the Tax Court's jurisdiction to review liabilities in connection with CDP appeals when the taxpayer has not received a notice of deficiency. These changes would authorize review of assessable penalties by the Tax Court even if the taxpayer had an opportunity for an administrative appeal.[21]

PRESENT LAW

A taxpayer may seek judicial review of an IRS liability determination in various federal courts. However, judicial review is sometimes unavailable.

Deficiency Litigation Before the Tax Court

Upon receipt of a statutory notice of deficiency from the IRS, a taxpayer generally has 90 days to file a petition with the Tax Court—the only court (other than the Bankruptcy Court) that can review

18 A repeal of the full payment rule would increase access to the district courts and the Court of Federal Claims. These courts have no jurisdiction if the taxpayer has petitioned the Tax Court. *See* IRC § 7422(e). Therefore, a repeal of the full payment rule would not erode judicial economy by allowing taxpayers to litigate the same issue in more than one court. Even if the full payment rule is repealed, however, Congress should consider the third recommendation—to expand the Tax Court's jurisdiction—because it's informal rules make it more accessible to unsophisticated taxpayers.

19 *See* IRC § 6343(a)(1)(D) (authority to release levies that create an economic hardship); Policy Statement 5-71, IRM 1.2.14.1.14 (Nov. 19, 1980) (establishing a policy to report accounts as currently not collectible when the taxpayer has no assets or income which are, by law, subject to levy).

20 For a similar proposal, see Carlton M. Smith, *Let the Poor Sue For Refund Without Full Payment*, 125 Tax Notes 131 (Oct. 5, 2009).

21 For a similar proposal, see Letter from Keith Fogg, Dir. Fed. Tax Clinic, Legal Svc. Ctr., Harvard L. Sch. to Hon. Lynn Jenkins, Chair, Subcomm. on Oversight of the Comm. on Ways & Means (Apr. 6, 2018) (comments on the Taxpayer First Act, proposal 2), http://proceduralltaxing.com/wp-content/uploads/2018/04/LetterandProposalsonTaxpayerFirstLegislation.pdf.

a tax deficiency before it is paid.[22] The Tax Court is particularly accessible to unsophisticated and unrepresented taxpayers because it uses informal procedures, which are even more informal if the dispute does not exceed $50,000.[23] However, confusing IRS correspondence, illiteracy, language barriers, and unequal access to competent tax professionals can cause taxpayers—particularly low income taxpayers—to miss the deadline for filing a petition with the Tax Court.[24]

The IRS can also assess certain penalties (called "assessable" penalties) without sending a notice of deficiency or otherwise triggering the Tax Court's jurisdiction.[25] The penalties in Subchapter B (*i.e.*, IRC §§ 6671-6725) are expressly excluded from the deficiency process.[26] Other penalties are implicitly excluded because they do not depend on a tax deficiency.[27] Thus, the Tax Court has no jurisdiction to review them before they are assessed.

Collection Due Process Litigation Before the Tax Court

After the IRS assesses a liability, the taxpayer may sometimes seek judicial review when the IRS tries to collect. Before the IRS levies property or after it has filed a notice of federal tax lien (NFTL), it must send a CDP notice, which gives the taxpayer the right to request a CDP hearing before the IRS's Appeals function.[28] Within 30 days of Appeals' determination, the taxpayer may petition the Tax Court for review.[29]

22 IRC §§ 6212, 6213. The 90-day period becomes 150 days if the notice is addressed to a person who is outside the United States. *Id*. The IRS may also assess tax without first sending a notice of deficiency if it determines that collection is in jeopardy. *See* IRC §§ 6851, 6861, 6862, 6871. This proposal would not change the existing jeopardy assessment procedures.

23 IRC § 7463.

24 *See, e.g.*, Carlton M. Smith, *Let the Poor Sue For Refund Without Full Payment*, 125 Tax Notes 131 (Oct. 5, 2009). The IRS is not required to send a notice of deficiency before summarily assessing a math or clerical error. IRC §§ 6213(b), (g). Although taxpayers who timely respond to math error notices can get the IRS to send them notices of deficiency and then file a petition with the Tax Court, low income taxpayers have difficulty understanding math error notices and timely navigating these procedures. *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 163.

25 Items such as self-assessed taxes and erroneous tax pre-payment credit claims may be assessed without the opportunity for review by the Tax Court because they are not "deficiencies." *See* IRC § 6201.

26 *See* IRC § 6671(a) ("The penalties and liabilities provided by this subchapter [IRC §§ 6671-6725] shall be paid upon notice and demand by the Secretary…"); *Smith v. Comm'r*, 133 T.C. 424, 428 n.3 (2009) (indicating the following penalties are expressly excluded from deficiency procedures: IRC §§ 6677(e) (failure to file information with respect to foreign trust), 6679(b) (failure to file returns, etc., with respect to foreign corporations or foreign partnerships), 6682(c) (false information with respect to withholding), 6693(d) (failure to provide reports on certain tax-favored accounts or annuities), 6696(b) (rules applicable with respect to IRC §§ 6694, 6695, and 6695A), 6697(c) (assessable penalties with respect to liability for tax of regulated investment companies), 6706(c) (original issue discount information requirements), 6713(c) (disclosure or use of information by preparers of returns), 6716(e) (failure to file information with respect to certain transfers at death and gifts)).

27 *See Smith v. Comm'r*, 133 T.C. at 429 n.4 (indicating the following penalties are implicitly excluded from the deficiency process: IRC §§ 6651 (failure to file a tax return or to pay a tax; the deficiency procedures apply only to the portion of the penalty attributable to the deficiency in taxes), 6677 (failure to file information returns with respect to certain foreign trusts), 6679 (failure to file returns, *etc.*, with respect to foreign corporations or foreign partnerships), 6686 (failure to file returns or supply information by domestic international sales corporation or foreign sales corporation), 6688 (assessable penalties with respect to information required to be furnished under sec. 7654), 6690 (fraudulent statement or failure to furnish statement to plan participant), 6692 (failure to file actuarial report), 6707 (failure to furnish information regarding reportable transactions), 6708 (failure to maintain lists of advisees with respect to reportable transactions), 6710 (failure to disclose that contributions are nondeductible), 6711 (failure by tax-exempt organization to disclose that certain information or services are available from the Federal Government), 6712 (failure to disclose treaty-based return positions), and 6707A (failure to include reportable transaction information with return)).

28 *See generally*, IRC §§ 6320 (lien), 6330 (levy).

29 IRC § 6330(d)(1).

Although the Tax Court has jurisdiction to consider certain challenges to the underlying liability that were properly raised during the CDP hearing,[30] it generally does not have jurisdiction to review assessable penalties or to determine that a taxpayer has an overpayment.[31] A taxpayer cannot challenge the underlying liability if he or she (1) received a statutory notice of deficiency, or (2) otherwise had an opportunity to dispute the liability, which the IRS interprets by regulation to include "a prior opportunity for a conference with Appeals that was offered either before or after the assessment of the liability."[32] Thus, CDP does not provide an avenue for judicial review of assessments against taxpayers who are subject to assessable penalties that they could have elevated to Appeals.[33]

Refund Litigation Before a District Court or the Court of Federal Claims

After the taxpayer pays a liability, a district court or the Court of Federal Claims may have jurisdiction to review the taxpayer's claim for refund.[34] However, these suits are subject to limitations.

Complicated Rules Limit the Timing of Claims and the Amounts That Can Be Refunded

Before filing a refund suit, the taxpayer must make a timely administrative claim.[35] To be timely, the administrative claim generally must be within the later of (i) three years from when the original return was filed or (ii) two years from when the tax was paid.[36] If the taxpayer can make a claim, the amount he or she can recover is limited based on when the claim is filed. If the claim is filed within the three-year period (*i.e.*, (i) above), the taxpayer can only recover amounts paid within three years, plus any

30 *See* Treas. Reg. §§ 301.6320-1(f)(2)A-F3; 301.6330-1(f)(2)A-F3.

31 See, *e.g.*, *Greene-Thapedi v. Comm'r*, 126 T.C. 1 (2006) (holding the Tax Court lacked jurisdiction to consider overpayment); *McLane v. Commissioner*, T.C. Memo. 2018-149 (same). For a legislative recommendation to address this problem, see National Taxpayer Advocate 2017 Annual Report to Congress 293-298 (Legislative Recommendation: *Amend IRC § 6330 to Allow the Tax Court Jurisdiction to Determine Overpayments*). For a long history of proposals to expand the Tax Court's refund jurisdiction, see Harold Dubroff & Brant J. Hellwig, The United States Tax Court, An Historical Analysis 315-322 (2d Ed. 2014), https://www.ustaxcourt.gov/book/Dubroff_Hellwig.pdf.

32 IRC § 6330(c)(2)(B); § 6330(c)(4)(A); Treas. Reg. §§ 301.6320-1(e)(3)A-E2 and 301.6330–1(e)(3)A–E2; IRM 8.22.8.3 (Aug. 9, 2017). *See also Our Country Home Enterprises, Inc. v. Comm'r*, 855 F.3d 773 (7th Cir. 2017); *Keller Tank Services II, Inc. v. Comm'r*, 854 F.3d 1178 (10th Cir. 2017); *Iames v. Comm'r*, 850 F.3d 160 (4th Cir. 2017), and *Lewis v. Comm'r*, 128 T.C. 48 (2007). Some have argued that these cases, which uphold the regulations, misinterpret the statute. *See, e.g.*, Chaim Gordon, *The Disjunctive Test for Challenging a Liability in a CDP Hearing*, 159 Tax Notes 1615 (Jun. 11, 2018). In CDP cases involving assessable penalties where the IRS has denied access to Appeals, however, the Tax Court may have jurisdiction. *See, e.g.*, *Yari v. Comm'r*, 143 T.C. 157 (2014), *aff'd*, 669 Fed. Appx. 489 (9th Cir. 2016) (claiming jurisdiction to review an assessable penalty under IRC § 6707A). Because the IRS does not view the receipt of a math error notice as a "prior opportunity" to dispute a liability, taxpayers may also obtain judicial review of math or clerical errors in the context of a CDP appeal. *See* IRM 8.22.8.3(9)(f) (Aug. 9, 2017).

33 IRC § 6330(c)(4)(A)(ii). Notably, if taxpayers were entitled to a pre-deprivation hearing under the Due Process Clause, commentators have suggested that CDP hearings do not provide sufficient protections. *See, e.g.*, Diane Fahey, *The Tax Court's Jurisdiction over Due Process Collection Appeals: Is It Constitutional*, 55 Baylor L. Rev. 453, 457 (2003) (pointing out that the taxpayer does not have the right to subpoena witnesses or records, the CDP hearing is not conducted by an independent adjudicator, and the only record of what transpired is the determination letter prepared by the appeals officer afterwards). Others have suggested that Appeals could be more independent. *See, e.g.*, American Bar Association, *Section of Taxation, Comments on Recent Practice Changes at Appeals* (May 9, 2017), https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/050917comments.pdf.

34 *See* 28 U.S.C. §§ 1346(a)(1), 1491.

35 IRC § 7422(a). The IRS must use deficiency procedures to disallow all or part of the EITC on original returns, but may use math error procedures in the case of errors on returns that are mathematical or clerical within the meaning of IRC § 6213(g)(2). The IRS also generally uses deficiency or math error procedures (rather than a notice of claim disallowance) to disallow other refundable credits on original returns. *See, e.g.*, PMTA 2007-0791 (May 2, 2016), and CCA 200202069 (Nov. 30, 2001).

36 IRC § 6511(a). If no return was filed, the limitations period is two years from when the tax was paid.

extension to file, before the date of the claim.[37] Otherwise, the taxpayer can only recover amounts paid within two years before the date of the claim.[38]

Following the administrative claim, the taxpayer can only file suit within a specific period and under certain conditions. The taxpayer cannot file suit before the earlier of when (1) the IRS disallows the claim, or (2) six months have lapsed and the IRS has not responded.[39] The taxpayer also generally cannot file suit later than two years after the IRS mails the notice of claims disallowance.[40]

The Full Payment Rule Bars Access by Those Who Cannot Pay

The full payment rule was established by the Supreme Court in *Flora I* and *II*, as described in the Appendix. It requires a taxpayer to pay an assessment in full before it can be challenged in a refund suit filed in a district court or the Court of Federal Claims. It may also require taxpayers to fully pay the penalties and interest if any dispute about these items would not be determined by the court's resolution of the underlying tax claim.[41]

Exceptions to the full payment rule

There are limited exceptions to the full payment rule. For "divisible" taxes, where the assessment may be divisible into a tax on each transaction or event (*e.g.*, excise taxes), the taxpayer need only pay enough to cover a single transaction or event.[42] For example, the trust fund recovery penalty under IRC § 6672(a)—a collection device that makes all "responsible persons" jointly and severally liable for a business's trust fund taxes—is a divisible tax. After the IRS assesses the penalty, the responsible person need only pay the amount due with respect to a single employee for a single quarter before filing a suit that will determine his or her overall liability for the trust fund recovery penalty.[43] In such cases, the government may, but is generally not required, to file a counterclaim for the unpaid amounts that involve the same or similar issue (*e.g.*, taxes for other employees), even if they relate to different periods.[44]

There are also several statutory exceptions to the full payment rule. For example, in 1998 Congress clarified that suits by estates would not be barred solely because the executor had elected to pay the

37 IRC § 6511(b)(2)(A).

38 IRC § 6511(b)(2)(B).

39 IRC § 6532(a)(1); 28 U.S.C. § 1346(a)(1) (granting jurisdiction).

40 IRC § 6532(a)(1).

41 *See Shore v. United States*, 9 F.3d 1524 (Fed. Cir. 1993), *rev'g* 26 Cl. Ct. 829, 830 (1992). Immediately after *Flora II*, however, this point was unsettled. *See, e.g.*, Erika L. Robinson, *Refund Suits in Claims Court: Jurisdiction and the Flora Full-Payment Rule After Shore v. United States*, 46 Tax Law. 827, 831-34 (1993) (describing four different views of the issue announced within a two-year period by the Claims Court); Martin M. Lore & L. Paige Marvel, *Claims Court Does About Face on Flora Full-Payment Rule*, 78 J. Tax'n 81, 81 (1993) (same).

42 *Flora II*, 362 U.S. at 175 n.38 (1960).

43 *See, e.g., Steele v. United States*, 280 F.2d 89 (8th Cir. 1960) (penalties under IRC § 6672 for failure to remit amounts withheld from employees' wages are divisible employee by employee). Similarly, the tax return preparer penalty under IRC § 6695 is divisible. *See Nordbrock v. United States*, 173 F.Supp.2d 959 (D. Ariz. 2000), *aff'd*, 248 F.3d 1172. (9th Cir. 2001).

44 *See* Fed. R. Civ. P. 13(a) (generally requiring any counterclaim that arises from "transaction or occurrence that is the subject matter of the opposing party's claim" provided the counterclaim(s) "do not require adding another party over whom the court cannot acquire jurisdiction"); Ct. Fed. Cl. R. 13(a) (same); *Flora II*, 362 U.S. at 166 ("the Government may but seemingly is not required to bring a counterclaim"). The government generally makes permissive counterclaims for unpaid portions of divisible taxes. *See* Chief Counsel Directives Manual (CCDM) 34.5.1.1.2.5 (Aug. 11, 2004). Counterclaims by the government for unpaid taxes help ensure the collections period under IRC § 6502(a) does not expire with respect to the unpaid amounts while refund litigation is pending with respect to the amounts that have been paid. *Id*.

estate tax in installments under IRC § 6166, and thus, had not fully paid.[45] In addition, in 1976 when Congress established assessable preparer penalties under IRC § 6694, it specifically provided that the preparer could contest them in district court after paying just 15 percent.[46] Congress took the same approach in 1982 when it established assessable penalties under IRC § 6700 (promoting abusive tax shelters) and § 6701 (aiding and abetting understatements).[47] As discussed below, however, no exception currently applies to most other assessable penalties—penalties assessed without providing the taxpayer a statutory notice of deficiency.[48]

The IRS May Sometimes Continue Collecting Disputed Amounts

Although the IRS is not authorized to assess or collect amounts in dispute before the Tax Court, the filing of a suit in a district court or the Court of Federal Claims does not automatically stop IRS assessment or collection activity.[49] Because the filing of a suit to recover a divisible portion of a liability did not prevent the IRS from collecting the remainder, in 1978, Congress provided that taxpayers could avoid collection of the remainder (*e.g.*, through the filing of a NFTL) by posting a bond.[50] Similarly, in 1998, Congress provided that the IRS can not levy to collect unpaid portions of divisible taxes while the taxpayer is contesting a divisible portion, provided the proceeding will determine his or her liability for the unpaid portion by reason of *res judicata* or *collateral estoppel*.[51] For matters not covered by this exception, even if a taxpayer manages to get an unpaid dispute before the court (*e.g.*, if the IRS sues to collect), the IRS may continue collection activity while the dispute is pending.[52]

45 Internal Revenue Service Restructuring and Reform Act (RRA 98), Pub. L. No. 105-206, § 3104(a), 112 Stat. 685, 731-32 (1998) (codified at IRC § 7422(j)).

46 Tax Reform Act, Pub. L. No. 94-455, § 1203(b)(1), 90 Stat. 1520, 1689 (1976) (codified at IRC § 6694(c)). This provision also prevents the IRS from collecting the unpaid portion of the penalty while a suit to determine the penalty is pending. IRC § 6694(c)(1).

47 Tax Equity and Fiscal Responsibility Act, Pub. L. No. 97-248, § 322(a), 96 Stat. 324, 612 (1982) (codified at IRC § 6703(c)).

48 Indeed, a court recently used the statutory exceptions to the full payment rule as a reason to hold that the full payment rule applied to penalties under IRC § 6707 for which Congress had not enacted an exception. *See Larson v. United States*, 888 F.3d 578 (2d Cir. 2018), *aff'g* 118 A.F.T.R.2d (RIA) 7004 (S.D.N.Y. 2016). *See also Diversified Grp., Inc. v. United States*, 841 F.3d 975 (Fed. Cir. 2016).

49 *Compare* IRC § 7421 (Anti-Injunction Act, prohibiting suits to restrain assessment or collection), *with* IRC § 6213(a) (providing an exception to the anti-injunction act for the Tax Court). Indeed, the petitioner in *Flora* had argued that Congress established the Tax Court to enable taxpayers to prevent the Government from collecting taxes while disputing a liability. *Flora II*, 362 U.S. at 638.

50 Pub. L. No. 95-628, § 9(a), 92 Stat. 3627, 3633 (1978) (codified at IRC § 6672(c)); Joint Committee on Taxation (JCT), JCS-22-77, *Description of H.R. 7320; Miscellaneous Revisions Relating to Various Timing Requirements Under the Internal Revenue Code* 9-10 (May 23, 1977) (explaining "[t]hese collection proceedings and the imposition of a lien against that person's property may seriously endanger the business or credit of the person against whom the penalty was assessed.").

51 RRA 98, Pub. L. No. 105-206 § 3433, 112 Stat. 685, 759 (1998) (codified at IRC § 6331(i)).

52 In some cases, the IRS may initiate a collection suit that may give the taxpayer an opportunity to dispute the assessment. *See, e.g.*, IRC § 7403(c) (granting jurisdiction for district courts to "finally determine the merits of all claims to and liens upon the property" subject to a lien in a suit to foreclose); *United States v. Maris, et al.*, 2015-1 U.S. Tax Cas. (CCH) 50,183 (D. Nev. 2015) (denying the government's motion to reduce an income tax assessment to a judgement because of questions about the validity of the assessment). However, the taxpayer does not control the timing of these suits and has no right to them. Moreover, the IRS generally does not need to file suit to levy or seize property. *See, e.g.*, IRC § 6331.

Bankruptcy Proceedings Before a Bankruptcy Court

A bankruptcy court "may" review certain tax liabilities, including unpaid assessable penalties that have not been contested and adjudicated in another tribunal.[53] However, the court's authority to determine a refund is limited, and the court may abstain from determining tax issues for various reasons.[54] For example, it is likely to abstain where the debtor is the only party who would benefit from the review (*i.e.*, the creditors would not benefit).[55] Ironically, the taxpayer is most likely to want judicial review of the assessment in these types of situations. Thus, a taxpayer may not be able to obtain judicial review of tax liabilities and penalties by a bankruptcy court. Moreover, if the tax assessment prompted the bankruptcy, then any such review might be conducted after the liabilities are assessed.

REASONS FOR CHANGE

The Full Payment Rule May Force Taxpayers into Bankruptcy

Congress established the Board of Tax Appeals (a predecessor of the Tax Court) in 1924, in part, because it determined that taxpayers who are faced with incorrect assessments should not have to declare bankruptcy to obtain judicial review. The House report explained that "[t]he right of appeal after payment of the tax is an incomplete remedy, and does little to remove the hardship occasioned by an incorrect assessment… [which] sometimes forces taxpayers into bankruptcy…." [56] Because the same concerns exist today, taxpayers who cannot pay should be able to obtain judicial review without declaring bankruptcy.[57]

The Full Payment Rule Discriminates Against Those Who Cannot Pay

Supreme Court Justice Whittaker's dissent in *Flora II* explained how the full payment rule discriminates against taxpayers who cannot pay, as follows:

> Where a taxpayer has paid … a part only of an illegal assessment and is unable to pay the balance within the two-year period of limitations, he would be deprived of any means of establishing the invalidity of the assessment and of recovering the amount illegally collected from him, unless it be held, … that full payment is not a condition upon the jurisdiction of District Courts to entertain suits for refund. Likewise, taxpayers who pay assessments in

53 *See* 11 U.S.C. § 505(a)(1) (bankruptcy courts "may" review the "amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid…"); 11 U.S.C. § 505(a)(2)(A) (barring review "if such amount or legality was contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction before the commencement of the case under this title"); *In re Wyly*, 552 B.R. 338 (N.D. Tex. 2016) (reviewing unpaid assessable penalties under IRC §§ 6038(c)(4)(B) and 6677(d)).

54 *See, e.g.*, *In re Luongo*, 259 F.3d 323, 330 (5th Cir. 2001).

55 *See, e.g.*, *In re New Haven Projects Ltd. Liab. Co.*, 225 F.3d 283, 289 (2d Cir. 2000) (affirming abstention in Title 11 because "the amount of unsecured debt was "*de minimis*….[and review of the tax issue] would only benefit the Debtor and [its] affiliates…"); *In re Hinsley*, 69 F. App'x 658 (5th Cir. 2003) (unpublished) (reversing the district court's decision not to abstain because "the only parties likely to benefit from the resolution of a debtor's dispute with the taxing authority are the debtor and his lienholder on property that is not a part of the estate"); *In re Perry*, 113 A.F.T.R.2d (RIA) 1370 (M.D. Ala. 2014) (abstaining because "the remaining issues concerning the extent of the liability of the debtor to the IRS and the determination of the extent of the tax lien do not affect the unsecured creditors…"); *In re Dees*, 369 B.R. 676, 680 (N.D. Fla. 2007) ("many courts have concluded that abstention is generally appropriate in no-asset Chapter 7 cases since the distribution to creditors is not affected.").

56 H.R. Rep. No. 68-179, 7 (1924) (quoted by *Flora II*, 362 U.S. at 159); Revenue Act of 1924, 43 Stat. 253, 297-336 (1924) (establishing the Board of Tax Appeals).

57 As noted above, however, even bankruptcy may not provide an opportunity for judicial review of a tax dispute because a bankruptcy court is likely to abstain if the outcome would not affect the taxpayer's other creditors.

> installments would be without remedy to recover early installments that were wrongfully collected should the period of limitations run before the last installment is paid.[58]

This policy concern is as true today as it was in 1960. Taxpayers should not be left without a remedy just because they cannot afford to fully pay an illegal assessment quickly.

Even when taxpayers who cannot afford to pay receive notices of deficiency, which grant access to the Tax Court, the full payment rule discriminates against them by limiting their choice of forum. The choice of forum can be a tactical decision. For example, a person filing in district court may be entitled to a trial by jury, whereas no jury trial is available in the Tax Court or the Court of Federal Claims.[59] Decisions by the Court of Federal Claims are appealable to the Court of Appeals for the Federal Circuit, whereas decisions by the Tax Court and the district courts are appealable to other circuit courts.[60] Considerations about whether to pay the disputed liability and claim overpayment interest or risk liability for underpayment interest may also come into play.[61] Although low income taxpayers may not be able to afford representation in more formal proceedings, *pro bono* representation may be available.[62] Moreover, there does not appear to be a good reason to give a choice of forum only to wealthy taxpayers and those with small assessments that they can pay.

58 *Flora II*, 362 U.S. at 195-96 (J. Whittaker, dissenting).

59 *See, e.g.*, 28 U.S.C. § 2402 (jury trials in district courts); *Statland v. United States*, 178 F.3d 465 (7th Cir.1999) (no right to jury trial in Tax Court or Court of Federal Claims).

60 IRC § 7482; 28 U.S.C. §§ 1291-1295.

61 *See, e.g.*, IRC § 6621(a) (underpayment and overpayment interest). In general, the government charges interest on underpayments and pays interest on overpayments at the same rate, however, it pays less interest on corporate overpayments than it charges on corporate underpayments. *Id*. Taxpayers who are able to pay can chose whether they would prefer to pay first and potentially earn overpayment interest, or litigate first and potentially owe underpayment interest.

62 *See* IRC § 7526 (authorizing grants to low income taxpayer clinics (LITCs)). In 2017, LITCs and their volunteers represented low income taxpayers (and appeared) in 1,013 cases before the Tax Court and in 41 cases in other Federal courts. TAS analysis of Form 13424K for grant year 2017 (Sept. 6, 2018); National Taxpayer Advocate, *Low Income Taxpayer Clinic Program Celebrates 20th Anniversary*, NTA Blog (Aug. 1, 2018), https://taxpayeradvocate.irs.gov/news/nta-blog-low-income-taxpayer-clinic-program-celebrates-20th-anniversary.

Pre-payment Review Poses No Risk to the Existence of Government

In *Flora I*, the Supreme Court justified the harsh results of the full payment rule by citing *Cheatham* and other cases from the 1800s.[63] Decided in 1875, *Cheatham* explained:

> If there existed in the courts, State or National, any general power of impeding or controlling the collection of taxes, or relieving the hardship incident to taxation, the very **existence of the government** might be placed in the power of a hostile judiciary. (Emphasis added.)[64]

These may have been legitimate concerns in the 1800s. In the 1700s, the perception that sympathetic local juries in America were refusing to be impartial in customs disputes led the British Parliament to shift all types of revenue litigation to courts sitting without juries.[65] In the absence of a full payment rule, taxpayers could have used the same tactic of filing suits in district courts before sympathetic local juries against the federal government. This threat was exacerbated by the economic state of the federal and state governments at the time. Indeed, in 1790, the federal government had defaulted on its debt obligations, and between 1873 and 1884, ten states had too.[66] In 1880, a taxpayer tried to use this very tactic—the taxpayer waited for the government to sue to collect, then asked the district court judge to instruct the jury to decide if the tax was constitutional. Afterward, the taxpayer appealed the decision to the Supreme Court.[67] This was not a frivolous argument because a few years later, in 1895, the Supreme Court held that portions of the income tax were unconstitutional.[68] Thus, there was at least a possibility that local courts could be used to choke off federal revenue.

This risk was higher in the 1800s because the tax base was narrow, with most revenues coming from high income individuals and businesses. Before 1942, the government collected more in excise taxes

63 *Flora I*, 357 U.S. at 68 ("It is essential to the honor and orderly conduct of the government that its taxes should be promptly paid," *quoting Cheatham v. United States*, 92 U.S. 85 (1875)). Although *Flora* did not repeat the "existence of government" rationale, *Cheatham* is mentioned seven times in *Flora I* and 20 times in *Flora II*. For a discussion of how Congress has increasingly provided taxpayers with procedural protections, overriding the sovereign's ancient power to require immediate payment of taxes, see Nina E. Olson, 2010 Erwin N. Griswold Lecture Before the American College of Tax Counsel, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 63 Tax Law. 227 (2010).

64 *Cheatham v. United States*, 92 U.S. 85, 89 (1875). *See also*, *Springer v. United States*, 102 U.S. 586, 594 (1880) ("The prompt payment of taxes is always important to the public welfare. It may be vital to the existence of a government."). Once the "government existence" rationale had been expressed in *Cheatham*, similar reasons were recited in other cases without further examination. *See, e.g., Phillips v. Comm'r*, 283 U.S. 589, 595 (1931) ("Property rights must yield provisionally to governmental need." *Citing Cheatham*); *Bull v. United States*, 295 U.S. 247, 259-60 (1935) ("taxes are the life-blood of government, and their prompt and certain availability an imperious need. Time out of mind, therefore, the sovereign has resorted to more drastic means of collection…). For a discussion of Congress's decision to expand procedural protections notwithstanding these ancient cases, see Nina E. Olson, 2010 Erwin N. Griswold Lecture Before the American College of Tax Counsel, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 63 Tax Law. 227 (2010). For a discussion of the historical basis for similar concerns which lead to the Anti-Injunction Act and how they have abated, see Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. 1683, 1719-1725 (2017).

65 *See United States v. Stein*, 881 F.3d 853, 859-860 (2018) (J. Pryor concurring).

66 *See* Carmen M. Reinhart, *This Time Is Different Chartbook: Country Histories on Debt, Default, and Financial Crises* 116 Nat'l Bureau Econ. Res. (NBER), Working Paper No. 15815 (Mar. 2010), http://www.nber.org/papers/w15815 (figure 66a). The federal government had another technical default after 1933 when Congress passed a resolution indicating it would not honor the "gold clause" in its bonds, which provided for repayment in gold. *Id.*; House Joint Resolution 192 (June 5, 1933). Although the Supreme Court held the government's actions were unlawful, it did not provide a remedy because it could not quantify the damages. *See Perry v. United States*, 294 U.S. 330 (1935).

67 *See Springer v. United States*, 102 U.S. 586 (1880).

68 *See Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895) (holding that income taxes on rent, interest and dividends were unconstitutional direct taxes because they were not apportioned among the states in accordance with the population).

than in either individual or corporate income taxes,[69] and in 1895, only the rich paid income taxes, as those with less than $4,000 (over $103,000 in today's dollars) in income were exempt.[70] Moreover, there was no broad-based wage withholding or similar pre-payment requirement.[71] Because there were fewer taxpayers, if a significant number filed suit before paying in local courts with local juries, they might have been able to threaten the federal government's very existence.

These historical concerns have subsided because: (1) the 16th Amendment was ratified in 1913, settling questions about the constitutionality of the income tax; (2) Congress increasingly delegated authority to Treasury to issue debt without specific authorization between 1917 and 1939, easing liquidity concerns;[72] (3) the federal government abandoned the gold standard in 1933 so that it could devalue the currency and pay its debts by printing money;[73] and (4) Congress substantially broadened the tax base in 1942, as shown in Figure 2.3.1, and adopted pre-payment mechanisms reducing its dependence on a relatively small number of taxpayers who might sue instead of paying.[74]

69 See Office of Management and Budget (OMB), *Historical Tables* (Table 2.2 - Percentage Composition of Receipts by Source: 1934-2023), https://www.whitehouse.gov/omb/historical-tables/.

70 See *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 444 (1895) ("The rate of taxation upon corporations and associations is in excess of the rate imposed upon individuals and associations. Persons having incomes of $4,000 or under pay nothing; corporations having like incomes pay two per cent. Persons having incomes of over $4,000 pay on the excess."). According to the inflation calculator at the Bureau of Labor Statistics (BLS) $4,000 in 1913 (the earliest period available) would be worth $103,036 as of September 2018. BLS, *CPI Inflation Calculator*, https://data.bls.gov/cgi-bin/cpicalc.pl. For a detailed discussion of the transformation of the income tax from a class tax to a mass tax and the automation that went along with it, see National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 1-62 (Study: *From Tax Collector to Fiscal Automaton: Demographic History of Federal Income Tax Administration, 1913-2011*).

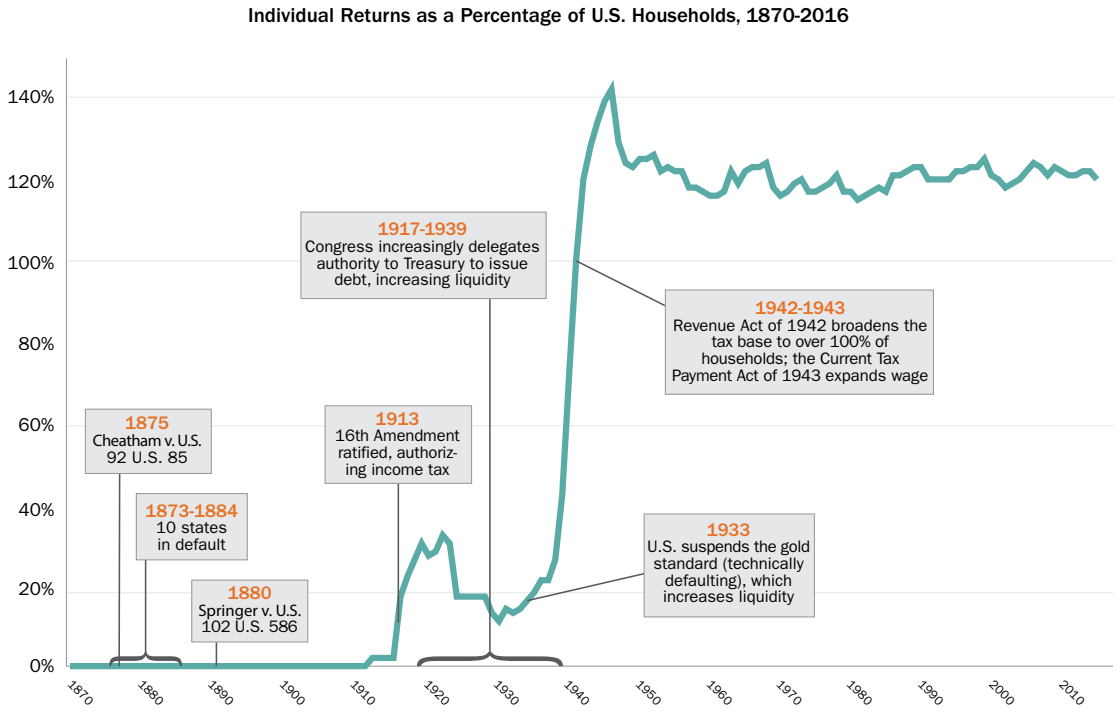
71 Revenue Act of 1942, ch 619, § 172, 56 Stat. 798, 887-92 (1942) (adopting wage withholding for a "Victory" tax); Current Tax Payment Act of 1943, ch. 120, § 2, 57 Stat. 126, 128 (1943) (expanding wage withholding to the income tax). For a detailed discussion of this evolution see, *e.g.*, Anuj C. Desai, *What a History of Tax Withholding Tells Us About the Relationship Between Statutes and Constitutional Law*, 108 Nw. U. L. Rev. 859, 896-902 (2014); Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 Buff. L. Rev. 685, 695-699 (1989); Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. 1683 (2017).

72 *See, e.g.*, George Hall & Thomas Sargent, *Brief History of US Debt Limits Before 1939*, 115 PNAS 2942-45 (Mar. 20, 2018), http://www.pnas.org/content/115/12/2942. Before 1917, each bond issuance had to be approved by Congress.

73 House Joint Resolution 192 (June 5, 1933).

74 Revenue Act of 1942, ch. 619, 56 Stat. 798 (1942). IRS, *Historical Fact Book, A Chronology 1646-1992*, 136 (1997) (noting the Revenue Act of 1942 "broadened the tax base by over 100%"); IRS, Pub. 447, *A History of the Internal Revenue Service, Income Taxes, 1862-1962*, 23 (1962) ("Taxpayers with income under $5,000 accounted for only 10 percent of the revenue collected in 1939. By 1948, these taxpayers accounted for over 50 percent of revenue collected. In 1939, 700,000 returns accounted for 90 percent of the total tax liability. By 1948, this number had climbed to 25 million returns."). *See also* National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 45 (Study: *From Tax Collector to Fiscal Automaton: Demographic History of Federal Income Tax Administration, 1913-2011*) (concluding "[I]n the first quarter-century, income tax was a concern largely to wealthy, white businessmen, doctors, and lawyers, who dealt with their Collectors, who in turn were locally prominent political appointees. All this changed during the second phase, when the exigency of World War II transformed the income tax into a mass revenue generator…").

FIGURE 2.3.1, The Risks to the Existence of Government Declined as It Broadened the Tax Base[75]



Congress must have deemed the risk of pre-payment review (at least in the absence of a local jury) to be minimal by 1924 when it established the Board of Tax Appeals (BTA) (*i.e.*, the predecessor of the Tax Court) as a pre-payment forum to hear most tax disputes—or at the latest by 1969 when it established the Tax Court as an Article I court, independent from the executive branch.[76] In 1998, when Congress established the right to a CDP hearing, it increased access to pre-payment judicial review by the Tax Court.[77] Thus, Congress must not have been concerned that increasing pre-payment review by the Tax Court could threaten the existence of government.

75 TAS analysis of data from the IRS Statistics of Income Division, the U.S. Bureau of the Census, and the Federal Reserve Bank of St. Louis (June 2018) (on file with TAS). The number of tax returns exceeds the number of households because more than one return can be filed by people living in a single Census-defined household. U.S. Census, Glossary, https://www.census.gov/glossary/#term (last visited, Oct. 31, 2018) (defining a household). For example, adult children and extended family may file separate returns but live in the same Census-defined household.

76 Revenue Act of 1924, 43 Stat. 253, 297-336 (1924) (establishing the BTA). Before 1969, the Tax Court was an executive branch agency. Tax Reform Act of 1969, Pub. L. No. 91-172, § 951, 83 Stat. 487, 730 (codified as IRC § 7441). While reciting concerns about dollars at stake in various courts, the *Flora* decisions were primarily based on decisions by prior courts and the assumptions of prior Congresses that full payment was required. *See Flora I*, 357 U.S. at 69 ("there does not appear to be a single case before 1940 in which a taxpayer attempted a suit for refund of income taxes without paying the full amount the Government alleged to be due"); *Flora II*, 362 U.S. at 167 (acknowledging that such cases existed, but stating "[i]f we were to overturn the assumption upon which Congress has acted, we would generate upon a broad scale the very problems Congress believed it had solved" and citing legislative history that characterized the full payment rule as present law).

77 RRA 98, Pub. L. No. 105-206 § 3401, 112 Stat. 685, 747 (1998) (codified at IRC §§ 6320 and 6330).

Similarly, legislation to eliminate any remaining gaps in this broad access to pre-payment judicial review would not pose a threat to the existence of the government. Moreover, the existence of the government has never depended on the swift collection of penalties.

In *Flora II*, the Supreme Court acknowledged that judicial precedent for the full payment rule was mixed, but its main policy justification for the rule was that allowing taxpayers to litigate in a pre-payment forum would pose risks to the "public purse."[78] The Court also worried about Tax Court cases flooding the district courts with frivolous claims by those hoping to settle for pennies on the dollar.[79] Judicial review of frivolous claims can help taxpayers to feel they have been heard and give a court the opportunity to clarify both substantive and procedural issues. However, the Court's concerns about them are now addressed by the penalties for frivolous submissions and refund claims.[80]

In addition, the Court assumed that the full payment rule would not result in hardship because taxpayers could "appeal the deficiency to the Tax Court without paying a cent."[81] To the extent it could result in a hardship, the Court suggested it was "a matter for Congress," inviting legislation to fill in those gaps.[82]

The Full Payment Rule Applies to More Penalties Today

The gaps in pre-payment judicial review have grown. When *Flora II* was decided in 1960, there were only four assessable penalties, two of which were divisible: (1) the trust fund recovery penalty (IRC § 6672), which is divisible (as noted above), (2) the penalty for delaying Tax Court proceedings (IRC § 6673), (3) the penalty for furnishing a fraudulent statement to employees (IRC § 6674), and (4) the penalty for excessive fuel tax refund claims (IRC § 6675), which is also divisible.[83] Today, by contrast, Subchapter B of Chapter 68 contains over 50 different assessable penalties (*i.e.*, the penalties

78 *Flora II*, 362 U.S. at 175 ("the Government has a substantial interest in protecting the public purse, an interest which would be substantially impaired if a taxpayer could sue in a District Court without paying his tax in full").

79 *Flora II*, 362 U.S. at 646-47 n.41. Indeed, after the Tax Court was granted jurisdiction in CDP appeals, the IRS reported that a small percentage of CDP litigants brought frivolous cases that drained a disproportionate amount of resources. *See* Joint Committee on Taxation (JCT), JCX-53-03, *Report of the JCT Relating to the Internal Revenue Service as Required by the IRS Reform and Restructuring Act of 1998* Appendix at 22 (May 20, 2003) (IRS letter to JCT) ("About 5% or 906 cases involve frivolous issue taxpayers. However … [f]rivolous claims occupy a disproportionate share of time over claims from taxpayers having substantive issues."). However, even some frivolous CDP cases have shed light on substantive and procedural issues. *See, e.g.*, *Ryskamp v. Comm'r*, 797 F.3d 1142 (D.C. Cir. 2015).

80 *See, e.g.*, IRC §§ 6702 ($5,000 penalty for frivolous submissions to the IRS, including requests for a CDP hearing); 6673 (authorizing sanctions and costs for frivolous submissions to a court); 7482 (same); Rule 5(c), Federal Rules of Civil Procedure (same); IRC § 6676 (penalty for excessive refund claims).

81 *Flora II*, 362 U.S. at 175. Indeed, the Supreme Court observed that "[t]he Board of Tax Appeals [the predecessor of the Tax Court] … was created by Congress to provide taxpayers an opportunity to secure an independent review of the Commissioner of Internal Revenue's determination of additional income and estate taxes by the Board in advance of their paying the tax found by the Commissioner to be due. Before the act of 1924 the taxpayer could only contest the Commissioner's determination of the amount of the tax after its payment." *Flora I*, 357 U.S. at 74 n. 20.

82 *Flora I*, 357 U.S. at 76.

83 Internal Revenue Code of 1954, Pub. L. No. 83-591, 68 Stat. 730, 828 (1954). The assessable penalty for excessive claims with respect to gasoline was enacted in 1956. Pub. L. No. 84-466, § 3, 70 Stat. 87, 90 (1956) (codified at IRC § 6675). The penalty for excessive fuel tax refund claims is divisible because it applies to each refund claim. Although there is no direct authority for this conclusion, it seems consistent with *Flora II* and the methodology employed by attorneys at the IRS for identifying divisible penalties. *See, e.g.*, *Flora II*, 362 U.S. 171, n.37 ("excise tax deficiencies may be divisible into a tax on each transaction or event."). *See also* CCA 201315017 (2013) (concluding that the penalty for failure to file certain information returns or payee statement was divisible).

between IRC §§ 6671 and 6725).[84] As the number of assessable penalties has risen, the fact that they cannot be contested in court before they are assessed and fully paid has become increasingly problematic.[85]

Procedural Barriers Can Cause Low Income Taxpayers to Miss the Opportunity to Petition the Tax Court

Before making an audit assessment, the IRS is generally required to send the taxpayer a notice of deficiency, which gives the taxpayer 90 days to petition the Tax Court.[86] It would be easier for low income taxpayers to understand these notices and how best to respond if someone explained them in person or by phone. However, the IRS generally audits low income and middle income taxpayers by correspondence or by using even more automated procedures that the IRS does not regard as audits (called "unreal audits").[87] Confusing IRS correspondence, illiteracy, language barriers, and unequal access to competent tax professionals can cause taxpayers—particularly low income taxpayers—to miss the deadline for filing a petition.[88] Indeed, a 2007 TAS study found more than one-quarter of taxpayers receiving an EITC audit notice did not understand that the IRS was auditing their return, 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.[89] In other words, there are circumstances in which deficiency procedures do not give taxpayers a realistic opportunity to petition the Tax Court.

84 Assessable penalties now include among other things, the penalties for: failure to file timely and accurate information returns (*e.g.*, IRC §§ 6677, 6679, 6682, 6693, 6698, 6699, 6707, 6707A, 6710, 6723), erroneous claims for refund (IRC § 6676), failure to disclose various things to various people or disclosing too much (*e.g.*, IRC §§ 6685, 6705, 6706, 6709, 6711, 6712, 6713, 6714, 6720C, 6721, 6722, 6725), aiding and abetting understatements (IRC § 6701), promoting tax shelters (IRC § 6700), making frivolous tax submissions (IRC § 6702), and the failure to keep certain records (*e.g.*, IRC §§ 6704, 6708).

85 Although some assessable penalties adopted after 1960 are divisible, many are not. *Compare* CCA 201150029 (2011) (IRC § 6677 not divisible); *Christian Laymen in Partnership, Ltd. v. United States*, 1989 U.S. Dist. LEXIS 15932 (W.D. Okla. Dec. 29, 1989) (IRC § 6698 not divisible); *Larson v. United States*, 888 F.3d 578 (2d Cir. 2018) (IRC § 6707 not divisible) *with* CCA 201315017 (2013) (IRC §§ 6721 and 6722 divisible) and CCA 200646016 (2006) (IRC § 6708 divisible). For many others, the divisibility issue has not been addressed. As one treatise explained, "[I]t is not always easy to determine whether a tax is divisible." Michael I. Saltzman, *IRS Practice and Procedure* ¶11.11[1][c] (Revised 2d ed. July 2017).

86 IRC § 6213. The 90-day period becomes 150 days if the notice is addressed to a person outside the U.S. *Id.*

87 For fiscal year (FY) 2017, 71 percent of the IRS's audits were conducted by correspondence — a figure that rises to 81 percent for individual returns with total positive income (TPI) of less than $200,000 and falls to 53 percent for individual returns with TPI of more than $200,000. IRS Data Book, 2017, Pub. 55B, 22 (Mar. 2018) (Table 9a). "Unreal audit" procedures include Automated Underreporter (AUR), Automated Substitute for Return (ASFR), math and clerical errors, and other automated programs. *See, e.g.*, National Taxpayer Advocate 2017 Annual Report to Congress 49-63 (Most Serious Problem: *Audit Rates*); National Taxpayer Advocate 2016 Annual Report to Congress 27-29 (Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*); National Taxpayer Advocate 2011 Annual Report to Congress 24 (Introduction to Revenue Protection Issues: *As the IRS Relies More Heavily on Automation to Strengthen Enforcement, There is Increased Risk It Will Assume Taxpayers Are Cheating, Confuse Taxpayers About Their Rights, and Sidestep Longstanding Taxpayer Protections*); Nina E. Olson, *What's an Audit, Anyway?*, NTA Blog (Jan. 25, 2012), https://taxpayeradvocate.irs.gov/news/what's-an-audit-anyway?category=Tax News.

88 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 100, 103-104. By comparison, when the IRS audited EITC claimants for its National Research Program, which utilized face-to-face and telephonic communications, 85 percent participated in the audit. *See* IRS, Pub. 5162, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* iii, 6, 8 (Aug. 2014). For a detailed description about why low income taxpayers miss these deadlines along with a similar proposal for reform, see Carlton M. Smith, *Let the Poor Sue For Refund Without Full Payment*, 125 Tax Notes 131 (Oct. 5, 2009).

89 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 100, 103-104. Similarly, a more recent survey of Schedule C taxpayers who had been audited found that only 38.8 percent for those audited by mail knew that they had been audited. National Taxpayer Advocate 2017 Annual Report to Congress vol. 2 148, 163-64 (Matthias Kasper, Sebastian Beer, Erich Kirchler & Brian Erard, *Audits, Identity Theft Investigations, and Taxpayer Attitudes: Evidence from a National Survey*).

Moreover, low income taxpayers did not have the same involvement in tax return filing and administration in 1960 when *Flora II* was decided. It was not until 1975 that Congress enacted the EITC as a means-tested tax credit to assist the working poor, and the EITC remained the only refundable tax credit until the Child Tax Credit was enacted in 1997.[90] After 1997, Congress increasingly began using the tax system to distribute benefits to low and middle income taxpayers, such as Economic Stimulus Payments, the Making Work Pay Credit, the Health Coverage Tax Credit, the First-Time Homebuyer Credit, the COBRA Premium Assistance Credit, the American Opportunity Tax Credit, the Adoption Credit, the Small Business Health Care Tax Credit, and the Premium Assistance Tax Credit.[91] In 2017, the maximum EITC was $6,318 and 27 million eligible workers and families received about $65 billion in EITC.[92] Moreover, in 2017 Congress doubled the maximum Child Tax Credit to $2,000, further increasing interactions between low and middle income taxpayers and the tax system.[93]

In addition, in 1960 the automation required for "unreal" audits did not exist. For example, it was not until 1989 that the IRS developed the first prototype of the "automated underreporter" matching system.[94] Thus, while the government's interest in keeping taxpayers out of court to protect the public purse has declined, the need for judicial review by low income taxpayers has increased.

EXPLANATION OF RECOMMENDATIONS

Clarify That the Full Payment Rule Does Not Apply to Liabilities Unless They Were Subject to Review by the Tax Court

Members of the Supreme Court and others have operated under the assumption that the full payment rule only applied where the taxpayer had an opportunity to petition the Tax Court to review them.[95] However, Congress has sometimes carved out exceptions to the full payment rule based on the assumption that it applied to assessable penalties that could not have been appealed to the Tax Court before payment.[96] Based in part on Congress's assumptions, the U.S. Court of Appeals for the Second

90 *See* Pub. L. No. 94-12, § 204, 89 Stat. 26, 30 (1975) (codifying the earned income tax credit (EITC) at IRC § 32); Pub. L. No. 105–34, § 101, 111 Stat. 788, 796 (1997) (codifying the child tax credit at IRC § 24).

91 *See, e.g.*, Congressional Budget Office, *Refundable Tax Credits* (2013), http://www.cbo.gov/sites/default/files/cbofiles/attachments/RefundableTaxCredits_One-Col.pdf; National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 43-44.

92 IRS, *EITC Fast Facts* (Jan. 29, 2018), https://www.eitc.irs.gov/partner-toolkit/basic-marketing-communication-materials/eitc-fast-facts/eitc-fast-facts.

93 *See* Pub. L. No. 115-97, § 11022, 131 Stat. 2054, 2073 (2017) (codified at IRC § 24). If the IRS offsets these benefits over a number of years, then by the time these offsets fully pay the liability so that the taxpayer can challenge the underlying assessment, he or she may not be able to recover the offsets from the early years, as discussed above.

94 IRS, *Historical Fact Book, A Chronology 1646-1992*, 232 (1997).

95 *Flora II*, 362 U.S. at 175 ("This contention [requiring taxpayers to pay the full assessments before bringing suits will subject some of them to great hardship] seems to ignore entirely the right of the taxpayer to appeal the deficiency to the Tax Court without paying a cent."); *Laing v. United States*, 423 U.S. 161, 208-09 (1976) (Blackmun, J., dissenting) ("the full-payment rule applies only where… the taxpayer has access to the Tax Court for redetermination prior to payment."). Indeed, critics of the *Larson* decision (discussed above), which applied the full payment rule to assessable penalties, have pointed out that the majority of the Supreme Court in *Laing* did not disagree with J. Blackmun's interpretation of *Flora II*, which would have limited the full payment rule to liabilities that could have been appealed to the Tax Court. *See, e.g.*, Andrew Velarde, *Taxpayer Asks Circuit for Do-Over on Full Payment Rule Holding*, 2018 TNT 113-5 (June 12, 2018) (quoting Carlton Smith). Similarly, Mr. Larson pointed out that the Solicitor General agreed with J. Blackmun. *See Larson v. United States*, Docket No. 17-502 (2d Cir. 2018) (petition for rehearing), *reprinted as*, *Individual Seeks Rehearing In Second Circuit Full Payment Rule Case*, 2018 TNT 113-11 (June 12, 2018).

96 *See* IRC §§ 6694(c), 6703(c).

Circuit recently confirmed that the full payment rule applies to assessable penalties.[97] If Congress decides to retain the full payment rule, it should clarify that the rule only applies where the taxpayer has received a notice of deficiency and had an opportunity to participate in a pre-payment review of the dispute by the Tax Court. If this or any similar recommendation is adopted, Congress should also provide that the IRS cannot collect the unpaid portion of a liability while refund litigation is pending concerning the same or similar issues, even if attributable to different periods.[98] The doctrines of *res judicata* and *collateral estoppel* should help to ensure that IRS does not re-litigate the same issues with respect to unpaid liabilities.[99]

By itself, this recommendation would not give the Tax Court jurisdiction to review assessable penalties. As noted below, we recommend that Congress authorize the Tax Court to review them. Expanding the Tax Court's jurisdiction would reduce litigation before the district courts and the Court of Federal Claims because a taxpayer could not litigate the same issue in both fora.[100]

Expand the Definition of Full Payment

The dissenters in *Flora II* worried that the refund limitations period could lapse while a taxpayer was trying to fully pay a liability that he or she wanted to dispute.[101] If Congress decides to retain the full payment rule, it should address this concern. It could do so by treating a liability as fully paid (for purposes of this rule) at the earlier of when the taxpayer has paid something and (a) the IRS classifies the account as currently not collectible due to hardship,[102] or (b) the taxpayer enters into an installment agreement.[103]

Expand the Tax Court's Jurisdiction to Hear Non-Deficiency Cases

If this recommendation is adopted, the Tax Court would have jurisdiction to review liabilities proposed by the IRS, where the taxpayer did not receive a notice of deficiency (*e.g.*, both the explicitly and implicitly assessable penalties). Before assessing assessable penalties, the IRS would be required to send the taxpayer a non-deficiency notice, which would be similar to a notice of deficiency, and give

97 *See Larson v. United States*, 888 F.3d 578 (2d Cir. 2018), *aff'g* 118 A.F.T.R.2d (RIA) 7004 (S.D.N.Y., 2016), *petition for rehearing filed*, Docket No. 16-CV-00245 (June 8, 2018). For a discussion of this case, see Significant Cases, *infra*. Practitioners have called for legislation in response to this decision. *See, e.g.*, Lawrence Hill & Richard Nessler, *IRS Penalty Assessments Without Due Process?,* 159 Tax Notes 1763 (June 18, 2018).

98 A full repeal of the full payment rule and similar proposals are not necessarily inconsistent with the Anti-Injunction Act (IRC § 7421), or the tax exception to the Declaratory Judgment Act (28 U.S.C. § 2201) if the taxpayer has paid some amount of the liability before filing suit and if the suit does not prevent the government from collecting unpaid amounts. If the full payment rule is repealed or limited, however, Congress should make clear that the suits it intends to authorize do not violate IRC § 7421 or 28 U.S.C. § 2201 with respect to unpaid amounts that will be decided in connection with the taxpayer's suit. For example, Congress could expand the scope of IRC § 6331(i) which prevents the IRS from levying while a taxpayer is litigating a divisible tax and IRC § 6331(i)(4)(B) which allows a court to enforce this rule by enjoining collection, notwithstanding IRC § 7421. *See, e.g., Beard v. United States*, 99 Fed. Cl. 147 (Fed. Cl. 2011) (enjoining the government's collection action).

99 *See, e.g.*, CCDM 34.5.1.1.2.2.4 (Aug. 11, 2004). The IRS authorizes its lawyers to make permissive counterclaims for the unpaid portions of divisible taxes where the counterclaim either relates to the periods in suit or involves the same or similar issues. CCDM 34.5.1.1.2.5 (Aug. 11, 2004).

100 *See* IRC § 7422(e).

101 *Flora II*, 362 U.S. at 195-96 (J. Whittaker, dissenting).

102 IRC § 6343(a)(1)(D) and Treas. Reg. § 301.6343-1(b)(4) require the IRS to release a levy that is creating an economic hardship. Rather than pursuing collection actions that would be unproductive, the IRS reports accounts as currently not collectible when the taxpayer has no assets or income which are, by law, subject to levy. *See* Policy Statement 5-71, IRM 1.2.14.1.14 (Nov. 19, 1980).

103 For a similar proposal, see Carlton M. Smith, *Let the Poor Sue For Refund Without Full Payment*, 125 Tax Notes 131 (Oct. 5, 2009). A similar rule applies to unpaid installments of estate tax under IRC § 7422(j).

the taxpayer a similarly reasonable period to file a petition with the Tax Court. As with a notice of deficiency, the IRS would be allowed to assess and collect the liabilities only after the Tax Court's review is complete or the period for filing suit has expired.

This proposal would give taxpayers access to a specialized and convenient judicial form. The Tax Court is less formal than a district court or the Court of Federal Claims. Since its inception, the Tax Court has been particularly accessible to *pro se* taxpayers and those wishing to be represented by non-attorneys.[104] Moreover, adjustments to the Tax Court's rules, jurisdiction, and Low Income Taxpayer Clinics and state and local bar association referral practices (*e.g.*, calendar call programs) have made it even more informal and accessible.[105] Over 70 percent of all Tax Court petitions were filed by self-represented taxpayers in 2015.[106]

Alternatively, Expand the Tax Court's Jurisdiction Under CDP

In lieu of expanding the Tax Court's jurisdiction to cover non-deficiency cases as recommended above, Congress could consider expanding its CDP jurisdiction to cover liabilities not subject to deficiency procedures, even if the taxpayer had an opportunity for an *administrative* review by Appeals. While this alternative would provide an opportunity for judicial review of assessable penalties, judicial review would only occur after they are assessed by the IRS.

Once a liability is assessed, the IRS may begin collection (*e.g.*, by offsetting refunds and issuing a lien notice), and the taxpayer's access to credit may be constrained. It is not clear why a taxpayer should not have the opportunity to appeal an IRS-asserted liability in court before the IRS assesses it, damages the taxpayer's credit, and begins the collection process. Nonetheless, an expansion of CDP could help to ensure that accessible penalties could be reviewed by a court before they are fully paid.

If Congress expands CDP, it should address several of its limitations. First, because the right to a CDP hearing is triggered by a lien or levy, a CDP appeal is not necessarily available to taxpayers whose liabilities are collected by offset (*e.g.*, refundable credits the taxpayer would otherwise have received in a subsequent year). Thus, Congress might want to require the IRS to send CDP notices before offsetting refundable tax credits and allow taxpayers to appeal the resulting determinations to the Tax Court.

104 Deborah A. Geier, *The Tax Court, Article III, and the Proposal Advanced by the Federal Courts Study Committee: A Study in Applied Constitutional Theory*, Cornell L. Rev., n. 23 (July 1991).

105 See IRC § 7463; Tax Court Rule 174(b). *See also* Harold Dubroff & Brant J. Hellwig, The United States Tax Court, An Historical Analysis 883-901 (2d Ed. 2014), https://www.ustaxcourt.gov/book/Dubroff_Hellwig.pdf; The Federal Courts Study Committee, *Report of The Federal Courts Study Committee* 70 (Apr. 2, 1990). For a summary of LITC activities to assist taxpayers before the Tax Court, see IRS Pub. 5066, *Assisting Taxpayers Face-to-Face with An Increasingly Automated Tax System*, LITC Program Report (Feb. 2018), https://www.irs.gov/pub/irs-pdf/p5066.pdf. For a discussion of Tax Court calendar call programs, see U.S. Tax Court, *Clinical, Student Practice & Bar Sponsored Calendar Call Program*, https://www.ustaxcourt.gov/clinics.htm (Aug. 6, 2018).

106 Hon. Peter J. Panuthos, *The United States Tax Court and Calendar Call Programs*, 68 Tax Law. 439, 440 (2015).

Second, the Tax Court does not have jurisdiction to order refunds in CDP appeals (*e.g.*, to order refunds of amounts that had been paid or offset).[107] Accordingly, Congress might also want to expand its jurisdiction to clarify that it could determine overpayments in connection with these appeals.[108]

In addition, both the time for requesting a CDP hearing, and the time for filing a Tax Court petition after receipt of an unfavorable CDP determination from Appeals is relatively short—only 30 days, as compared to 90 days (or 150 days if addressed to a taxpayer overseas) after the IRS sends a notice of deficiency.[109] Moreover, unlike the notice of deficiency, the CDP notice and the CDP determination do not list the last day for the taxpayer to file the request for a hearing or to petition the Tax Court.[110] Congress should also address these problems in connection with any expansion of CDP (*e.g.*, by giving taxpayers as long to respond to a CDP notice as they have in responding to a notice of deficiency and listing that deadline on the notice).

Expanding the Tax Court's jurisdiction will not open the floodgates to litigation. Between 2004 and 2017 only 1.41 percent of the taxpayers who received a CDP notice requested an administrative hearing (*i.e.*, 365,686 out of 25,991,970) and only 0.08 percent filed a petition with the Tax Court (*i.e.*, 20,248 out of 25,991,970).[111] Moreover, because these percentages include taxpayers with disputes about both collection alternatives and the underlying liability, we might expect this more limited expansion to increase the number of petitions by an even smaller fraction.

107 *See, e.g.*, *Greene-Thapedi v. Comm'r*, 126 T.C. 1 (2006) (holding the Tax Court lacked jurisdiction to consider overpayment in CDP appeal); *McLane v. Comm'r*, T.C. Memo. 2018-149 (same, even though the taxpayer had not received a notice of deficiency). For further discussion of these issues and the need for legislation, see, *e.g.*, Keith Fogg, *Tax Court Reiterates That It Lacks Refund Jurisdiction in Collection Due Process Cases*, Procedurally Taxing Blog (Oct. 4, 2018), http://proceduralltaxing.com/tax-court-reiterates-that-it-lacks-refund-jurisdiction-in-collection-due-process-cases/.

108 For a legislative recommendation to address this problem, see National Taxpayer Advocate 2017 Annual Report to Congress 293-298 (Legislative Recommendation: *Amend IRC § 6330 to Allow the Tax Court Jurisdiction to Determine Overpayments*).

109 *Compare* IRC §§ 6330(a)(2)(C), (3)(B), and 6330(d)(1) *with* IRC §§ 6212, 6213. For an example of the problems this short period creates, see, *e.g.*, Carlton Smith, *Atuke v. Comm'r: A Clearly Unfair Dismissal for Lack of Jurisdiction Where the Taxpayer Had No Time to Timely File*, Procedurally Taxing Blog (Apr. 19, 2016), https://proceduralltaxing.com/atuke-v-commr-a-clearly-unfair-dismissal-for-lack-of-jurisdiction-where-the-taxpayer-had-no-time-to-timely-file-2/. By the time the IRS mailed CDP notices to individuals in FY 2017, the average delinquency was about 751 days old, and a median of about 441 days old. TAS analysis of Individual Master File, Individual Accounts Receivable Dollar Inventory (Sept. 23, 2018). Observing that CDP cases take longer for the government to resolve than deficiency cases once they reach the Tax Court, some have argued that taxpayers should not have to respond more quickly in CDP cases than in deficiency cases. *See* Carlton Smith & Keith Fogg, *Tax Court Collection Due Process Cases Take Too Long*, 130 Tax Notes 403 (Jan. 24, 2011); Carlton Smith & Keith Fogg, *Collection Due Process Hearings Should Be Expedited*, 125 Tax Notes 919 (Nov. 23, 2009).

110 For a recommendation to address this problem, see National Taxpayer Advocate 2017 Annual Report to Congress 299-306 (Legislative Recommendation: *Amend IRC §§ 6320, 6330, and 6015 to Require That IRS Notices Sent to Taxpayers Include a Specific Date by Which Taxpayers Must File Their Tax Court Petitions, and Provide That a Petition Filed by Such Specified Date Will Be Treated As Timely*).

111 TAS analysis of CDP data (Sept. 5, 2018).

Appendix: Summary of The Flora Decisions

After the IRS recharacterized a loss that Mr. Flora had incurred in 1950 as a capital loss (rather than an ordinary loss) and sent him a notice of deficiency, he did not timely petition the Tax Court. The IRS then assessed a $28,908.60 deficiency. The taxpayer made payments totaling $5,058.54, and then submitted a claim for refund, which the IRS disallowed. In 1956, he filed suit in the U.S. District Court for the District of Wyoming requesting a refund under the Tucker Act, 28 U.S.C. § 1346(a)(1). The Tucker Act authorized the court to hear suits for the recovery of:

> "*any internal-revenue tax* alleged to have been erroneously or illegally assessed or collected, or *any penalty* claimed to have been collected without authority or *any sum* alleged to have been excessive or in any manner wrongfully collected…" [Emphasis added.][112]

The District Court held that because the deficiency was not fully paid the court "should not maintain" the action, but it nonetheless entered a judgement for the government on the merits due to a conflict among the circuits about whether full payment was required.[113] On appeal, the Court of Appeals for the Tenth Circuit remanded the case with instructions to dismiss for lack of subject matter jurisdiction. It reasoned the legislative history of the Revenue Act of 1924, which established the Board of Tax Appeals (BTA, the predecessor of the Tax Court) suggested that the BTA was established as a pre-payment forum to mitigate the "hardship imposed on taxpayers by an inflexible 'pay first, litigate later' rule" and said "the Supreme Court has consistently indicated that full payment of a tax deficiency is a prerequisite to a judicial claim for refund."[114] It also suggested that allowing taxpayers to pay a small portion of a deficiency and sue for a refund of that portion would undermine the requirement of IRC § 7422 that a taxpayer must make an administrative claim for refund before filing suit.

In 1958, in *Flora I* the Supreme Court affirmed with only one dissent. While acknowledging that the Tucker Act authorized the court to determine "any sum," which could be construed as a clear grant of authority, it cited a "sharp division of opinion among the lower courts" as evidence that the language was ambiguous and said that because the Tucker Act is a waiver of sovereign immunity it had to be construed narrowly.[115] It agreed with the Tenth Circuit that the hardship Congress was attempting to alleviate when it subsequently created the BTA as a pre-payment forum was the hardship of having to fully pay a deficiency before filing suit under the Tucker Act. It discounted the taxpayer's argument that BTA addressed another hardship faced by taxpayers who filed suit in a district court before fully paying—that the IRS could continue to collect the disputed liability during the litigation.[116]

The Court also relied on its decision in *Cheatham*, which was decided in 1875 before the Tucker Act was amended in 1921, and involved the limitations period for filing refund claims.[117] In *Cheatham,* the taxpayer argued that her filing was not late, in part, because she had no right of action until the tax

112 28 U.S.C. § 1346(a)(1).

113 *Flora v. United States*, 142 F. Supp. 602, 604-05 (D. Wyo. 1956), *remanded by* 246 F.2d 929 (10th Cir. 1957), *aff'd*, *Flora I,* 357 U.S. 63 (1958), *aff'd*, *Flora II*, 362 U.S. 145 (1960).

114 *Flora*, 246 F.2d 929, 930-31 (10th Cir. 1957) (quoting from *Old Colony Trust Co. v. Comm'r*, 279 U.S. 716 (1929) where the Court said "Before the act of 1924 [establishing the Board of Tax Appeals] the taxpayer could only contest the Commissioner's determination of the amount of the tax after its payment").

115 *Flora I* at 65.

116 *Id.* at 74. It also cited a statement in a House report for a bill that removed a dollar limitation from the Tucker Act that suggested that Congress assumed that full payment was required. *Id*. at 74-75.

117 *Cheatham v. United States*, 92 U.S. 85, 89 (1875).

was fully paid. Although the Court accepted the taxpayer's assertion that she had no right of action until the tax was fully paid, it found reasons for why her filing was nonetheless late.[118] In *dicta*, the *Cheatham* Court discussed its understanding about the full payment rule and the policy reasons for the rule. After quoting this discussion from *Cheatham*, the Court said in *Flora I* that "[c]onsistent with that understanding, there does not appear to be a single case before 1940 in which a taxpayer attempted a suit for refund of income taxes without paying the full amount the Government alleged to be due."[119] This statement was wrong. After a handful of cases were discovered,[120] the Court granted a petition for rehearing and issued *Flora II*, which provides a broader justification for its decision.

In *Flora II*, the Court discounted the argument that the Tucker Act's reference to the recovery of "any sum" plainly authorized a taxpayer to pay a fraction of the liability and then sue to recover it. It said that "any internal-revenue tax" could be interpreted as the entire tax assessment, and that "any sum" could be interpreted as amounts that were neither taxes nor penalties, such as interest. However, it concluded that it faced a "vexing situation—statutory language which is inconclusive and legislative history which is irrelevant."[121]

Next, the Court acknowledged that before the Tucker Act a taxpayer could sue a tax collector (personally) to recover a partial payment of tax and that there was no indication that the Tucker Act intended to change that result, but discounted the implication that there was no full payment rule.[122] The Court reasoned that its "carefully considered *dictum*" in *Cheatham* (discussed above) prevented it from accepting the analogy between an action under the Tucker Act and a common law action against a collector, especially since the *Cheatham* Court was construing a claim-for-refund statute from which, it said, the relevant language of the Tucker Act was presumably taken.[123]

Next, the Court discussed post-Tucker-Act legislation that suggested Congress assumed there was a full payment rule, including (1) legislation in 1924, which established the Board of Tax Appeals, (2) the Declaratory Judgment Act of 1934, as amended in 1935 (DJA, 28 U.S.C. § 2201 *et seq.*,), and (3) IRC § 7422(e). It reiterated the argument expressed in *Flora I* that the BTA was established to provide a pre-payment forum based on the assumption that none existed. Then the Court observed that the DJA granted jurisdiction to "declare the rights and other legal relations of any interested party seeking such declaration," but specifically carved out tax cases.[124] The Court cited legislative history of the DJA, which said that applying it to taxes would work a "radical departure," and also cited commentators who thought the radical departure being referenced was a departure from the full payment rule, which they apparently assumed to exist.[125]

118 The *Cheatham* court disagreed with the taxpayer's argument that the limitations period "cannot begin to run until the cause of action accrued, which in this case was not until the money was paid.... and that it could not have been intended by Congress that the very short limitation of six months should include any time before the money was paid, during which they had no right of action." *Cheatham*, 92 U.S at 87. However, it did not question her assertion that she had no right of action before the money was paid in full.

119 *Flora I*, 357 U.S. at 69. The dissent cited cases from the Eighth, Third, and Second Circuits that had declined to read a full payment rule into the Tucker Act in or after 1940. *Id.* at 76.

120 *See Flora II*, 362 U.S. at 171 n.37 (categorizing the cases) and 181-85 n.3 (J. Whittaker, dissenting, discussing the cases). Justice Frankfurter wrote a separate opinion in *Flora II* to explain that he changed sides because of the majority's mistake and the persuasiveness of the dissent's research in *Flora II*. *Flora II*, 362 U.S. at 177 (J. Frankfurter, concurring with the dissent).

121 *Id.* at 152.

122 *Id.* at 152-53.

123 *Id.* at 155.

124 28 U.S.C. § 2201.

125 *Flora II*, 362 U.S. at 164-65 n.29.

The Court went on to discuss IRC § 7422(e), which specifies what happens if a taxpayer is in tax litigation before a district court or the Court of Claims when the IRS mails the taxpayer a notice of deficiency proposing additional adjustments with respect to tax which is the subject of the taxpayer's suit. It says the suit is stayed to allow the taxpayer to file a petition with the Tax Court, and if the taxpayer does, the original court loses jurisdiction. If the taxpayer decides to remain in the original court, the IRS may bring a counterclaim; and if it does, the taxpayer generally has the burden of proof. The Court suggested that IRC § 7422(e) did not prescribe rules for all the permutations that could occur without a full payment rule. Thus, it said Congress has assumed these problems are nonexistent except in the rare case where the taxpayer sues in a district court and the IRS then notifies him of an additional deficiency.[126]

Finally, the Court said the prevailing view before 1940 was that full payment had to precede suit, overturning the full payment rule would substantially impair the "public purse," and could be expected to shift a "great portion" of the Tax Court's litigation into the district courts.[127]

Four Justices dissented in *Flora II*. The dissenting opinion first discussed a handful of tax cases from before 1940 where taxpayers who had only paid a portion of their liability had petitioned district courts or the Court of Claims in which the government had not objected or if it had, where the court had rejected the full payment rule.[128] Next, it pointed out that the *dictum* in *Cheatham* that was the focus of the majority opinion "did not embrace, and certainly was not directed to, the question whether full payment of an assessment is a condition upon the jurisdiction of a District Court to entertain a suit for refund."[129] Likewise, it said that the majority's reliance on legislative histories other than the Tucker Act, which were "not directed to the question we have here," were "too imprecise for the drawing of such a far-reaching inference, involving, as it does, the interpolation of a drastic qualification into the otherwise plain, clear and unlimited provisions of the statute."[130]

The dissent dismissed any disharmony resulting from concurrent jurisdiction by the Tax Court and district courts because they already had such jurisdiction with respect to refund claims.[131] It dismissed concerns about revenue loss due to the fact that filing in district court did not stay collection, and in any event, taxpayers could stay collection by filing a petition with the Tax Court.[132] Rather, it worried that taxpayers who could only pay a portion of an invalid assessment within the limitations period would be deprived of any means to recover amounts illegally collected.[133]

Turning to the history of the Tucker Act, the dissent observed that in the 1830s tax collectors could be personally liable for monies illegally collected. This potential liability prompted them to withhold disputed collections from the government. In 1839, Congress expressly prohibited collectors from retaining these collections, and in 1845, the Supreme Court held in *Cary v. Curtis* that the 1839 legislation had also terminated the longstanding common law right of action by taxpayers against the collectors.[134] This case prompted Congress to give taxpayers the right to sue the collectors to recover

126 *Flora II*, 362 U.S. at 166.
127 *Id.* at 166-177.
128 *Id.* at 181-185 (J. Whittaker, dissenting).
129 *Id.* at 185.
130 *Id.* at 192.
131 *Id.* at 194 n.17.
132 *Id.* at 194.
133 *Id.* at 195.
134 *Id.* (citing *Cary v. Curtis*, 44 U.S. 236, 239 (1845)).

amounts which were not lawfully "payable in part or in whole."[135] Thus, there was no historic basis for the full payment rule.

The Tucker Act was subsequently enacted in 1887, without making specific reference to taxes or any full payment requirement. It only covered small claims. Taxpayers could still sue collectors for large tax claims. In 1921, the Court held that claims against collectors were personal in nature, and thus, taxpayers could not recover if the collector died. The 1921 amendment to the Tucker Act was designed to allow taxpayers with large tax claims to sue the government in district court.

When Congress amended the Tucker Act in 1921 it went looking for language it could use to refer to taxes. According to the dissent, the language it selected "was chosen because, in another statute, it referred to all of the actions which could be brought for refund of internal revenue taxes" (*i.e.*, what is now IRC § 7422(a), a provision that requires taxpayers to file administrative claims with the IRS before suing in court) and thus should be interpreted broadly.[136] Moreover, the clear language that permitted taxpayers to sue for "any sum," persuaded the dissent that there was no full payment rule.

135 *Flora II*, 362 U.S. at 187 (J. Whittaker, dissenting). The dissent noted that although the statute referred to Customs Collectors, the Court ruled that the legislation also authorized suits to recover illegally collected internal revenue taxes. *Id.* at 188.

136 *Id.* at 195. It also pointed out that the statute at issue in *Cheatham* did not even include the "any sum" language, which makes it even broader. *Id.* at 190 n.15.