

## STRENGTHEN TAXPAYER RIGHTS IN JUDICIAL PROCEEDINGS

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### Legislative Recommendation #45

## Repeal *Flora* and Expand the Tax Court’s Jurisdiction, Giving Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can

### PRESENT LAW

IRC § 7442 defines the jurisdiction of the United States Tax Court. IRC § 6212 requires the IRS to issue a “notice of deficiency” before assessing certain liabilities. When the IRS issues a notice of deficiency, IRC § 6213 authorizes the taxpayer to petition the U.S. Tax Court within 90 days (or 150 days if the notice is addressed to a person outside the U.S.) to review the IRS determination.

IRC §§ 6201 and 6671(a) authorize the IRS to assess other liabilities, including so-called “assessable” penalties (*e.g.*, penalties codified in IRC §§ 6671-6725), without first issuing a notice of deficiency. Assessable penalties are not computed by reference to a tax deficiency. For example, penalties under IRC §§ 6721 and 6707 for failure to file various information returns are assessable penalties. Although IRC § 6671(a) specifically references only the “penalties and liabilities provided by this subchapter” (*i.e.*, Chapter 68, Subchapter B of the Code), the IRS takes the position that various international information reporting penalties located in Chapter 61 are also assessable, such as the penalty under IRC § 6038 for failure to file Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations.<sup>1</sup> A taxpayer generally may not obtain judicial review of assessable penalties in the Tax Court, except in connection with the Tax Court’s limited jurisdiction to review the results of an IRS “Collection Due Process” (CDP) hearing, as described below.

The Anti-Injunction Act (IRC § 7421) and the tax exception to the Declaratory Judgment Act (28 U.S.C. § 2201) generally prohibit lawsuits to restrain the assessment or collection of tax. Once a taxpayer pays the tax, however, the taxpayer may file suit in a U.S. district court or the U.S. Court of Federal Claims under 28 U.S.C. § 1346(a)(1) to recover any tax the taxpayer believes has been erroneously assessed or collected. In *Flora v. United States*, 362 U.S. 145 (1960), the U.S. Supreme Court held that, with limited exceptions, a taxpayer must have “fully paid” the assessment (called the “full payment rule”) before filing suit in these courts.

One exception to the full payment rule applies to “divisible” taxes. When an assessment may be divisible into a tax on each transaction or event, the taxpayer need only pay enough to cover a single transaction or event before filing suit. 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 unpaid trust fund taxes — is a divisible tax. After the IRS assesses the penalty, the responsible person need only pay the amount

<sup>1</sup> See, *e.g.*, Internal Revenue Manual (IRM) 21.8.2.20.2, Form 5471 Penalties Systemically Assessed from Late-Filed Form 1120 Series or Form 1065 (Mar. 26, 2018); IRM 21.8.2.21.2, Form 5472 Penalties Systemically Assessed from Late-Filed Form 1120 Series (Mar. 18, 2020).

due with respect to a single employee for a single quarter before filing suit.<sup>2</sup> IRC § 6331(i) provides that (notwithstanding IRC § 7421), if a taxpayer pays part of a “divisible” tax and sues for a refund in a proper federal trial court, the IRS generally cannot levy to collect the unpaid divisible tax during the suit’s pendency. But IRC § 6331(i)(2) only applies this levy ban to employment taxes and the trust fund recovery penalty.<sup>3</sup>

IRC § 6694(c) provides another exception to the full payment rule for those who have paid 15 percent of certain assessable preparer penalties. Similarly, IRC § 6703(c) provides an exception for those who have paid 15 percent of the assessable penalties under IRC §§ 6700 (promoting abusive tax shelters) and 6701 (aiding and abetting understatements).

Under IRC § 7422(a), the taxpayer must make a timely administrative claim for refund before filing suit. To be timely, IRC § 6511(a) generally requires that an administrative claim be filed by the later of (i) three years from the date the original return was filed or (ii) two years from the date the tax was paid. If the claim is filed within the three-year period, then IRC § 6511(b)(2)(A) provides that the taxpayer can only recover amounts paid within three years, plus any extension of time to file, before the date of the claim. Otherwise, IRC § 6511(b)(2)(B) provides that the taxpayer can only recover amounts paid within two years before the date of the claim.

If the IRS issues a notice of claim disallowance, IRC § 6532 provides that the taxpayer has two years from the date of the notice in which to file suit. If the IRS does not issue a notice of claim disallowance, the taxpayer may file suit after six months.<sup>4</sup> However, IRC § 7422(j) provides a special exception to the full payment rule for suits by estates that have elected to pay the estate tax in installments under IRC § 6166.

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

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

Under IRC § 7803(a)(3), the Commissioner must ensure that IRS employees are familiar with and act in accord with the taxpayer rights afforded by the IRC, including the right to appeal most IRS decisions in an independent forum.

<sup>2</sup> See, e.g., *Steele v. United States*, 280 F.2d 89 (8th Cir. 1960).

<sup>3</sup> In such cases, the government may, but generally is 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. See Fed. R. Civ. P. 13(a); Chief Counsel Directives Manual (CCDM) 34.5.1.1.2.5 (Aug. 11, 2004). Counterclaims by the government for unpaid taxes help ensure the collection 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.*

<sup>4</sup> Rev. Rul. 56-381, 1956-2 C.B. 953, says that the period for filing suit does not begin to run until the IRS sends the notice.

## REASONS FOR CHANGE

All taxpayers should have an opportunity to obtain judicial review of adverse IRS determinations. Under current law, however, there are circumstances in which taxpayers do not have that right. Assessable penalties are not subject to judicial review unless a taxpayer is wealthy enough to first fully pay the penalties assessed.<sup>5</sup>

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

In 2000, U.S. Tax Court Judge Howard Dawson wrote:

It is unfortunate and unfair that a taxpayer's financial condition is an important aspect of forum selection. It is obviously inequitable to have a procedure where the doors of certain courts are open to those with the financial resources to pay their putative tax liability in advance and closed to those who cannot raise the money required. This is an aberration in the system that is indefensible. It clearly favors rich individuals and wealthy corporations over low- and middle-income persons and small corporations. I am too much of a populist to believe that this is good for the tax litigation system. Why should a select group of taxpayers be able to utilize differences in court procedures to gain a significant advantage? Why should some taxpayers be able to select a forum where the trend of prior decisions seems more conducive to success while others for financial reason do not have that choice?<sup>6</sup>

Due to its specialization, the Tax Court is better equipped to consider tax controversies than other courts. Moreover, it is more accessible to unsophisticated and unrepresented taxpayers than other courts because it uses informal procedures, particularly in disputes that do not exceed \$50,000.<sup>7</sup> 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 after receiving a notice of deficiency.<sup>8</sup> A TAS study found that when the IRS sent an audit notice to those claiming the Earned Income Tax Credit (EITC), a refundable tax credit for the working poor, almost 40 percent did not understand what the IRS was questioning, and only about half the respondents felt like they knew what they needed to do. Thus, many are also unlikely to understand whether and how to timely petition the Tax Court and could benefit from alternative avenues for obtaining judicial review.

5 However, the IRS faces significant litigation risk if, without express authorization, it continues to treat penalties that are not located in Chapter 68, Subchapter B, as assessable. See National Taxpayer Advocate 2020 Annual Report to Congress (Most Serious Problem: *International: The IRS's Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS*).

6 Howard Dawson, *Should the Federal Civil Tax Litigation System Be Restructured?*, 40 TAX NOTES 1427 (2000).

7 IRC § 7463.

8 See, e.g., Carlton M. Smith, *Let the Poor Sue for Refund Without Full Payment*, 125 TAX NOTES 131 (Oct. 5, 2009). Low income taxpayers have difficulty understanding math error notices and making timely abatement requests so that they can get access to the Tax Court. See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 163-171 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*).

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

## RECOMMENDATIONS<sup>9</sup>

- Amend IRC § 6212 to expand the deficiency process to cover all penalties in Title 26, including the penalties located in Chapter 68, Subchapter B, and those located in Chapter 61, so that taxpayers can obtain judicial review by the Tax Court before they are assessed.
- Clarify that a person is not required to fully pay before filing suit in a U.S. district court or the U.S. Court of Federal Claims under 28 U.S.C. § 1346(a)(1) (*i.e.*, repeal the *Flora* Court's full payment rule).<sup>10</sup>
- Amend IRC §§ 7442 and 7422 to give the Tax Court jurisdiction to determine liabilities in refund suits to the same extent as the U.S. district courts and the U.S. Court of Federal Claims, without regard to how much of the liability has been paid.<sup>11</sup>

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<sup>9</sup> For more detail, see National Taxpayer Advocate 2018 Annual Report to Congress 364-386 (Legislative Recommendation: *Fix the Flora Rule: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*).

<sup>10</sup> IRC § 7422(e) and the doctrines of *res judicata* and *collateral estoppel* should help ensure the IRS does not re-litigate the same issues with respect to unpaid liabilities. See, e.g., CCDM 34.5.1.1.2.2.4 (Aug. 11, 2004).

<sup>11</sup> If the full payment rule is repealed, is limited, or does not apply to the Tax Court's new jurisdiction to review claims, 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. It should also prevent the IRS from collecting the unpaid portions during these suits. It could do so by expanding 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.

**Legislative Recommendation #46****Authorize the Tax Court to Order Refunds or Credits in Collection Due Process Proceedings Where Liability Is at Issue****PRESENT LAW**

IRC § 6512(b) grants the Tax Court jurisdiction in deficiency suits to determine that a taxpayer made an overpayment of income tax for the period at issue and that such amount must be refunded or credited to the taxpayer.<sup>1</sup> IRC § 6511(a) generally requires a taxpayer to file a claim for credit or refund by the later of three years from the time a return was filed, or if no return was filed, two years from the time the tax was paid.

IRC § 6330 allows a taxpayer in certain instances to challenge the underlying liability in a Collection Due Process (CDP) proceeding. Unlike in deficiency cases, however, IRC § 6330 does not grant the Tax Court jurisdiction to determine the extent to which a taxpayer has made an overpayment and is entitled to a refund or credit.<sup>2</sup> For a taxpayer in a CDP proceeding to receive a refund, the taxpayer must first fully pay the assessed tax for the taxable year(s) at issue, file a timely administrative refund claim with the IRS under IRC § 6511, and if the claim is denied, timely file a refund suit in a U.S. district court or the U.S. Court of Federal Claims.

**REASONS FOR CHANGE**

The limitation on the Tax Court's jurisdiction to determine an overpayment and order a refund in CDP cases prevents taxpayers from obtaining resolution of their tax disputes in a single forum and imposes unnecessary financial and administrative burdens on taxpayers and the court system.

The Tax Court, unlike other federal courts, is a pre-payment forum that ordinarily allows taxpayers to dispute their liabilities without having to first pay them in full. In a CDP proceeding, only taxpayers who did not otherwise have an opportunity to dispute their underlying liabilities are permitted to contest them.

CDP taxpayers who may challenge the existence or amount of an underlying tax liability pursuant to IRC § 6330(c)(2)(B) should, similar to taxpayers in deficiency proceedings, have the opportunity to obtain a refund in a pre-payment forum, rather than be required to full-pay the liability and then incur additional time and expense to dispute the liability in another forum. Amending IRC § 6330 to explicitly grant the Tax Court the authority to determine overpayments and order refunds in CDP cases will protect taxpayers' right to finality, reduce taxpayer burden, and better ensure the IRS collects the correct amount of tax. Furthermore, the Tax Court could apply to CDP proceedings its long-established procedures for determining an overpayment in deficiency cases.

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

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

## RECOMMENDATION

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

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

**Legislative Recommendation #47****Provide That the Time Limits for Bringing Tax Litigation Are Subject to the Judicial Doctrines of Forfeiture, Waiver, Estoppel, and Equitable Tolling****PRESENT LAW**

Various provisions in the IRC authorize proceedings or suits against the government, provided such actions are brought timely. These actions are generally brought in the U.S. Tax Court, a U.S. district court, or the U.S. Court of Federal Claims.<sup>1</sup>

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

**U.S. Tax Court**

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

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

IRC § 7442, which describes the jurisdiction of the Tax Court, does not specify that prescribed periods for petitioning the Tax Court are not subject to equitable doctrines. Absent a timely filed petition, however, the Tax Court has held it does not have jurisdiction to redetermine deficiencies, hear appeals from IRS CDP proceedings, consider stand-alone innocent spouse claims, or decide whistleblower claims.

Regarding deficiency cases and stand-alone innocent spouse cases, several U.S. Courts of Appeal have agreed with the Tax Court that the time limits for filing a Tax Court petition are jurisdictional requirements that cannot be modified by applying equitable doctrines. In addition, two appellate courts agreed with the Tax Court that the deadline for filing a petition in a CDP case is not subject to equitable tolling.<sup>2</sup> However, a different appellate court, interpreting language in IRC § 7432 (the whistleblower statute) that is “nearly

1 Some tax claims may also be heard by U.S. bankruptcy courts. For a fuller discussion of this recommendation, see National Taxpayer Advocate 2017 Annual Report to Congress 283-292 (Legislative Recommendation: *Equitable Doctrines: Make the Time Limits for Bringing Tax Litigation Subject to the Judicial Doctrines of Forfeiture, Waiver, Estoppel, and Equitable Tolling, and Clarify That Dismissal of an Untimely Petition Filed in Response to a Statutory Notice of Deficiency Is Not a Decision on the Merits of a Case*).

2 *Boechler v. Comm'r*, 967 F.3d 760, 765 (8th Cir. 2020); *Duggan v. Comm'r*, 879 F.3d 1029, 1034 (9th Cir. 2018).



identical in structure” to the language in IRC § 6330 (the CDP statute) reversed a Tax Court dismissal and held that the filing deadline for whistleblower cases is not jurisdictional and is subject to equitable tolling.<sup>3</sup>

### Other Federal Courts

Sometimes taxpayers may obtain judicial review in federal courts other than the Tax Court if they sue within a specified period. For example, a refund suit can generally be brought in the U.S. district courts or in the U.S. Court of Federal Claims within two years from the date the IRS denies a claim. There is a split among the circuits regarding whether the statutory period for seeking refunds is subject to equitable doctrines.<sup>4</sup>

Similarly, taxpayers may sue in a U.S. district court to enjoin enforcement of a wrongful levy or sale or to recover property (or proceeds from the sale of property) if they do so within a specified period (generally, within two years of levy). Several federal courts have held that the period is not subject to equitable tolling,<sup>5</sup> but at least one appellate court has held that it is.<sup>6</sup>

Taxpayers may also bring suit, if they do so within the specified periods, to seek civil damages in a U.S. district court or bankruptcy court regarding unauthorized actions by the IRS. Courts have differed on whether equitable doctrines can toll the period for bringing suit.<sup>7</sup>

## REASONS FOR CHANGE

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

Unrepresented taxpayers may be less likely to anticipate the severe consequences of filing a Tax Court petition even one day late, and most Tax Court petitioners do not have representation. The IRS itself occasionally provides inaccurate information regarding the filing deadline to a taxpayer, and taxpayers have been harmed by relying on that erroneous information.<sup>8</sup>

3 *Myers v. Comm’r*, 928 F.3d 1025, 1036 (D.C. Cir. 2019), *reh’g en banc denied*, No. 18-1003 (D.C. Cir. Oct. 4, 2019).

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

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

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

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

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



The “right to a fair and just tax system”<sup>9</sup> requires that equitable doctrines be available to taxpayers in the rare cases where they would apply. Taxpayers would still be required to demonstrate that an equitable doctrine applies in their cases, and courts could still dismiss petitions or complaints as untimely.

## RECOMMENDATION

- Enact a new section of the IRC, or amend IRC § 7442, to provide that the periods in the IRC within which taxpayers may petition the Tax Court or file suit in other federal courts are not jurisdictional and are subject to the judicial doctrines of forfeiture, waiver, estoppel, and equitable tolling.<sup>10</sup>

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<sup>9</sup> See IRC § 7803(a)(3)(J) (identifying the “right to a fair and just tax system” as a taxpayer right).

<sup>10</sup> If this change to the IRC were enacted, late-filed claims would no longer be dismissed for lack of jurisdiction, which would mean the taxpayer would have no right to pursue a refund suit. As a result, we are also recommending that IRC § 7459(d) be amended to make clear that a dismissal based on timeliness is not a decision on the merits.

**Legislative Recommendation #48****Amend IRC § 7456(a) to Authorize the Tax Court to Sign Subpoenas for the Production of Records Held by a Third Party Prior to a Scheduled Hearing****PRESENT LAW**

IRC § 7456(a) authorizes the Tax Court to issue subpoenas for the “production of all necessary returns, books, papers, documents, correspondence, and other evidence, from any place in the United States at any designated place of hearing...” The Tax Court interprets IRC § 7456(a) as permitting it to issue subpoenas for the production of documents by a third party at trial sessions, at depositions, and at pre-trial conferences. Outside of these designated hearings, the Tax Court does not believe it has the authority to issue a subpoena directing a third party to produce records in advance of a trial session to facilitate pre-trial discovery.

**REASONS FOR CHANGE**

Efficient pre-trial discovery is an important means of limiting litigation and promoting settlement between the parties. Rule 45 of the Federal Rules of Civil Procedure (FRCP) allows for the use of subpoenas to secure pre-trial discovery of documents, including third-party documents to be produced prior to the scheduling of any hearing or deposition. The Tax Court, however, is governed by Tax Court Rules rather than the FRCP. Unlike FRCP Rule 45, the analogous Tax Court rule (Tax Court Rule 147) does not provide for the use of subpoenas to enforce delivery of documents prior to a hearing, such as a deposition or a trial.

The Tax Court’s authority was addressed in *Johnson v. Commissioner*.<sup>1</sup> In that case, the IRS issued a third-party subpoena to Bank of America for the production of documents. The taxpayer assented to the subpoena. Likewise, Bank of America expressed a willingness to comply, but not before the date specified in a properly authorized subpoena.

The IRS filed a motion asking the Tax Court to permit it to issue a subpoena directing Bank of America to produce the requested documents “prior to” the date of the scheduled trial session. The motion stated that obtaining the documents in advance of the scheduled trial might obviate the need for Bank of America to appear at the hearing and facilitate settlement discussions with the taxpayer that might eliminate the need for a trial. The Court stated that the IRS’s position was “not unreasonable” and that production of the documents might benefit all parties. Nevertheless, it concluded that it lacked the authority to issue such a subpoena. Under IRC § 7456(a), the Court concluded it could only authorize a third-party subpoena for the production of documents on the hearing date.

Recognizing the potential benefits arising from earlier document delivery, the Court’s order discussed several workarounds the litigants could employ to secure the documents before trial. The National Taxpayer Advocate believes this should not be necessary. There is no good reason the authority of the Tax Court should be more limited than the authority of other federal courts to issue subpoenas that would allow the parties to engage in pre-trial discovery to resolve or narrow issues without the need for judicial involvement.

<sup>1</sup> *Johnson v. Comm’r*, Docket No. 17324-18 (Dec. 26, 2019).

## RECOMMENDATION

- Amend IRC § 7456(a) to authorize the Tax Court to sign subpoenas directing the production of records held by a third party prior to a scheduled hearing.<sup>2</sup>

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<sup>2</sup> A similar recommendation was proposed on the Procedurally Taxing blog in January 2020. See William Schmidt, *Serving Subpoenas: Designated Orders 12/23/19 to 12/27/19*, PROCEDURALLY TAXING, <https://procedurallytaxing.com/serve-subpoenas-designated-orders-12-23-19-to-12-27-19/> (Jan. 29, 2020).

## Legislative Recommendation #49

# Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is *De Novo*

## PRESENT LAW

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

In 2008, the Tax Court held that the scope of its review in IRC § 6015(f) cases, like its review in IRC § 6015(b) and (c) cases, is *de novo*, meaning it may consider evidence introduced at trial that was not included in the administrative record.<sup>1</sup> In 2009, the Tax Court held that the standard of review in IRC § 6015(f) cases is also *de novo*, meaning that the Tax Court will consider the case anew, without deference to the IRS’s determination.<sup>2</sup>

In 2009, the IRS Office of Chief Counsel (Chief Counsel) issued guidance to its attorneys instructing them to argue, contrary to the Tax Court’s holdings, that review in all IRC § 6015(f) cases is limited to issues and evidence presented before the IRS Appeals or Examination functions and that the proper standard of review is abuse of discretion.<sup>3</sup> In 2011, the National Taxpayer Advocate recommended that Congress amend IRC § 6015 to reflect the Tax Court’s holdings and reject the IRS’s position.

In June 2013, following an appellate court decision affirming the Tax Court’s holdings, Chief Counsel issued guidance instructing its attorneys to cease arguing that the scope and standard of review in IRC § 6015(f) cases are not *de novo*.<sup>4</sup> In June 2013, Chief Counsel also issued an Action on Decision stating that although the IRS disagrees that section 6015(e)(1) provides for both a *de novo* standard of review and a *de novo* scope of review, the IRS would no longer argue that the Tax Court should limit its review to the administrative record or review section 6015(f) claims solely for an abuse of discretion.<sup>5</sup>

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

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

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

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

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

In 2019, Congress added paragraph (7) to IRC § 6015(e). It provides that “any review of a determination made under this section is de novo by the Tax Court.”<sup>6</sup> However, this *de novo* review is limited to consideration of “(A) the administrative record established at the time of the determination, and (B) any additional newly discovered or previously unavailable evidence.” The provision does not define the terms “newly discovered” or “previously unavailable.”

## REASONS FOR CHANGE

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

The provision may be intended to encourage the IRS and taxpayers to compile a complete administrative record or resolve cases without litigation. In some cases, however, taxpayers — and particularly taxpayers not represented by counsel — may not appreciate the significance of certain evidence or the consequences of failing to present it to the IRS. In other cases, taxpayers may present relevant evidence during trial to a neutral third party — the judge — that they are reluctant to share with the IRS, such as evidence of the other joint filer’s domestic violence or abuse.<sup>7</sup>

Some taxpayers could be deprived of meaningful Tax Court review — particularly taxpayers who filed Tax Court petitions when their requests for relief went unanswered for six months — because the administrative record may consist of little more than the taxpayer’s skeletal responses to the information solicited by Form 8857, Request for Innocent Spouse Relief, and the IRS may argue that the taxpayer’s evidence is not “newly discovered” or “previously unavailable.”<sup>8</sup> If the IRS argues under IRC § 6015(e)(7) that the taxpayer’s evidence should not be considered because it was available but not presented when the IRS made its determination and the Tax Court accepts this argument, the court may decide the case *de novo* based on the scant evidence contained in the administrative record.<sup>9</sup> To enable the Tax Court to make the correct decision based on the merits, the National Taxpayer Advocate believes the court should be permitted to consider all evidence, whether or not it could have been provided to the IRS in a prior administrative proceeding.

Finally, some taxpayers who wish to obtain review by a federal court that is *de novo* in scope may pay the asserted tax and bring a refund suit before a U.S. district court or the U.S. Court of Federal Claims. But this approach carries the risk that these courts may conclude they lack jurisdiction to hear innocent spouse claims.<sup>10</sup> To address these cases, the National Taxpayer Advocate recommends the statute be amended to allow courts to consider all evidence in IRC § 6015 cases.

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

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

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

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

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

## RECOMMENDATION

- Remove IRC § 6015(e)(7)(A) and (B) and revise IRC § 6015(e)(7) to provide: “The standard and scope of any review of a determination made under this section by the Tax Court or other court of competent jurisdiction shall be *de novo*.”<sup>11</sup>

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11 This recommendation averts the possibility that the language in IRC § 6015(e)(7) that “[a]ny review of a determination under this section shall be reviewed *de novo* by the Tax Court” could be construed as conferring exclusive jurisdiction on the Tax Court to hear innocent spouse claims, which would preclude innocent spouse relief in collection, bankruptcy, and refund cases litigated in other federal courts and would be inconsistent with IRC § 6015(e)(1)(A) (conferring Tax Court jurisdiction “in addition to any other remedy provided by law”). Such an interpretation would also be inconsistent with the legislative recommendations *Clarify That Taxpayers May Raise Innocent Spouse Relief as a Defense in Collection Proceedings and Bankruptcy Cases*, *infra*, and *Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits*, *infra*.

## Legislative Recommendation #50

# Clarify That Taxpayers May Raise Innocent Spouse Relief as a Defense in Collection Proceedings and Bankruptcy Cases<sup>1</sup>

## PRESENT LAW

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

If a taxpayer files a petition within 90 days from the date the IRS issues its final notice of determination, the United States Tax Court has jurisdiction to determine the appropriate relief. The Tax Court’s jurisdiction to decide innocent spouse claims does not appear to be exclusive; IRC § 6015(e)(1)(A) provides that an individual may petition the Tax Court for review of an innocent spouse determination “in addition to any other remedy provided by law.”<sup>2</sup>

However, the Tax Court’s review is not *de novo*, but is limited to “(A) the administrative record established at the time of the determination, and (B) any additional newly discovered or previously unavailable evidence.”<sup>3</sup>

The Tax Court does not have jurisdiction over collection suits arising under IRC §§ 7402 or 7403 or over bankruptcy proceedings arising under Title 11 of the United States Code. Some federal courts with jurisdiction have considered taxpayers’ innocent spouse claims and determined that they are entitled to innocent spouse relief, which is consistent with IRC § 6015(e)(1)(A).<sup>4</sup> These courts have not limited the scope of their consideration of the innocent spouse claim.

However, other federal courts have held that the Tax Court’s jurisdiction to decide innocent spouse claims is exclusive and have declined to consider such claims in collection or bankruptcy cases.<sup>5</sup>

- 1 Our recommendation that Congress clarify that taxpayers may seek innocent spouse relief in collection proceedings and bankruptcy cases addresses issues similar to those discussed in our recommendation that Congress clarify that taxpayers may seek innocent spouse relief in refund cases. See *Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits, infra*.
- 2 Moreover, IRC § 6015(e)(3) provides that the Tax Court loses jurisdiction to the extent jurisdiction is acquired by the district court or the U.S. Court of Federal Claims in a refund suit, indicating that the Tax Court does not have exclusive jurisdiction over innocent spouse claims.
- 3 IRC § 6015(e)(7). This provision was enacted by the Taxpayer First Act, Pub. L. No. 116-25, § 1203, 133 Stat. 981, 988 (2019). The National Taxpayer Advocate recommends revising IRC § 6015(e)(7) to remove this limitation on the Tax Court’s scope of review. See *Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is De Novo, supra*.
- 4 See, e.g., *United States v. Diehl*, 460 F. Supp. 1282 (S.D. Tex. 1976), *aff’d per curiam*, 586 F.2d 1080 (5th Cir. 1978) (IRC § 7402 suit to reduce an assessment to judgment); *In re Pendergraft*, 119 A.F.T.R.2d (RIA) 1229 (Bankr. S.D. Tex. 2017) (bankruptcy proceeding).
- 5 *United States v. Boynton*, 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007) (IRC § 7402 suit to reduce an assessment to judgment); *United States v. Cawog*, 97 A.F.T.R.2d (RIA) 3069 (W.D. Pa. 2006) (IRC § 7403 suit to foreclose on federal tax liens); and *In re Mikels*, 524 B.R. 805 (Bankr. S.D. Ind. 2015) (bankruptcy proceeding). Moreover, if the innocent spouse claim is raised for the first time in a refund suit, then it is arguable that the IRS, although it may make a recommendation to the Justice Department about whether relief should be granted, does not make a “determination” that the Tax Court would have jurisdiction to review. If the IRS has not made a determination and IRC § 6015(e)(7) does not apply, the statute should not be construed as conferring exclusive jurisdiction on the Tax Court.



## REASONS FOR CHANGE

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

Legislation is needed to clarify that the statutory language of IRC § 6015 conferring Tax Court jurisdiction “in addition to any other remedy provided by law” does not give the Tax Court exclusive jurisdiction to determine innocent spouse claims and that U.S. district courts and bankruptcy courts may also consider whether innocent spouse relief should be granted.<sup>6</sup>

## RECOMMENDATION

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

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<sup>6</sup> As noted above, IRC § 6015(e)(7) provides that “[a]ny review of a determination under this section shall be reviewed de novo by the Tax Court.” The National Taxpayer Advocate agrees that the standard and scope of Tax Court review of innocent spouse cases should be *de novo*. However, the new provision could be construed as conferring exclusive jurisdiction on the Tax Court to hear innocent spouse claims, which would be inconsistent with IRC § 6015(e)(1)(A). Such an interpretation would also be inconsistent with this recommendation relating to raising innocent spouse as a defense in collection suits and bankruptcy proceedings and with the recommendation to *Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits, infra*. For this reason, the National Taxpayer Advocate recommends clarifying that the scope and standard of review are *de novo* in innocent spouse cases adjudicated by the Tax Court “or other court of competent jurisdiction,” thereby avoiding the inference that the Tax Court has exclusive jurisdiction over innocent spouse claims. See *Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is De Novo, supra*.

**Legislative Recommendation #51****Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits<sup>1</sup>****PRESENT LAW**

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

**U.S. Tax Court**

Under IRC § 6015(e), the Tax Court has jurisdiction to review the IRS’s denial of a claim for innocent spouse relief and to determine the appropriate relief. There is no right to a jury trial in Tax Court, and while the standard of review of a denial of a claim for innocent spouse relief under IRC § 6015 is *de novo*, the scope of the Tax Court’s review is limited to “(A) the administrative record established at the time of the determination, and (B) any additional newly discovered or previously unavailable evidence.”<sup>2</sup>

**Other Federal Courts**

Taxpayers who pay a proposed deficiency before filing a Tax Court petition and whose administrative claims for tax refunds have been denied by the IRS cannot bring refund suits in the Tax Court, but they may seek refunds by filing suit in a U.S. district court or in the U.S. Court of Federal Claims. They may raise their innocent spouse claims for the first time in proceedings before those courts.<sup>3</sup>

IRC § 6015(e) provides that a taxpayer’s right to petition the Tax Court for innocent spouse relief is provided “[i]n addition to any other remedy provided by law.” Despite the quoted language, a U.S. district court concluded in the case of *Chandler v. United States* that it lacked jurisdiction to consider a taxpayer’s innocent spouse claim in a refund suit arising under IRC § 7422.<sup>4</sup>

A jury trial is available if a refund suit is brought in a U.S. district court, and the scope of the court’s review in a refund suit is *de novo* (*i.e.*, not limited, for example, to the administrative record).<sup>5</sup>

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- 1 This recommendation that Congress clarify that taxpayers may seek innocent spouse relief in refund cases addresses issues similar to those discussed in our recommendation *Clarify That Taxpayers May Raise Innocent Spouse Relief as a Defense in Collection Proceedings and Bankruptcy Cases*, *supra*.
  - 2 IRC § 6015(e)(7). This provision was enacted as part of the Taxpayer First Act, Pub. L. No. 116-25, § 1203, 133 Stat. 981, 988 (2019). The National Taxpayer Advocate recommends revising IRC § 6015(e)(7) to remove this limitation on the Tax Court’s scope of review. See *Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is De Novo*, *supra*.
  - 3 If the innocent spouse claim is raised for the first time in a refund suit, then it is arguable that the IRS, although it may make a recommendation to the Justice Department about whether relief should be granted, does not make a “determination” that the Tax Court would have jurisdiction to review. If the IRS has not made a determination and IRC § 6015(e)(7) does not apply, the statute should not be construed as conferring exclusive jurisdiction on the Tax Court.
  - 4 *Chandler v. United States*, 2018 U.S. Dist. LEXIS 173880 (N.D. Tex. 2018), *adopting* 2018 U.S. Dist. LEXIS 174482 (N.D. Tex. 2018). The decision quoted *United States v. Elman*, 2012 U.S. Dist. LEXIS 173026, at \*8 (N.D. Ill. 2012), which stated that “although the statute itself does not address whether the Tax Court’s jurisdiction is exclusive, courts interpreting the statute have concluded that it is.”
  - 5 See *Vons Companies v. United States*, 51 Fed. Cl. 1, 5-6 (2001), noting “the axiomatic principle that tax refund cases are de novo proceedings” in which the court’s determination of the taxpayer’s tax liability is “based upon the facts and merits presented to the court and does not require (or even ordinarily permit) this court to review findings or a record previously developed at the administrative level.” (Citations omitted.)

## REASONS FOR CHANGE

The *Chandler* decision is inconsistent with decisions by other federal courts that for decades have allowed taxpayers to seek innocent spouse relief in refund suits.<sup>6</sup> The decision in *Chandler*, by foreclosing district court review of innocent spouse claims, leaves taxpayers with only one forum — the Tax Court — in which to seek review of adverse IRS determinations. Taxpayers are thus deprived of judicial review of their cases that is *de novo* in scope. Because there is no right to a jury trial in the Tax Court, the *Chandler* decision also undermines taxpayers' right to have their cases decided by a jury.

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

Legislation is needed to clarify that the statutory language of IRC § 6015, conferring Tax Court jurisdiction “in addition to any other remedy provided by law” does not give the Tax Court exclusive jurisdiction to determine innocent spouse claims, and that U.S. district courts and the U.S. Court of Federal Claims are also authorized to consider whether innocent spouse relief should be granted in refund suits.<sup>7</sup> Clarification will prevent further confusion as to whether seeking innocent spouse relief is allowable in those courts and will provide uniformity among all federal courts.<sup>8</sup>

## RECOMMENDATION

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

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

7 IRC § 6015(e)(3) provides that the Tax Court loses jurisdiction to the extent jurisdiction is acquired by a U.S. district court or the U.S. Court of Federal Claims in a refund suit, indicating that the Tax Court does not have exclusive jurisdiction over innocent spouse claims.

8 As noted above, IRC § 6015(e)(7) provides that “[a]ny review of a determination under this section shall be reviewed *de novo* by the Tax Court.” The National Taxpayer Advocate agrees that the standard and scope of Tax Court review of innocent spouse cases should be *de novo*. However, the new provision could be construed as conferring exclusive jurisdiction on the Tax Court to hear innocent spouse claims, which would be inconsistent with IRC § 6015(e)(1)(A). Such an interpretation would also be inconsistent with this recommendation relating to seeking innocent spouse relief in refund suits and with the recommendation to *Clarify That Taxpayers May Raise Innocent Spouse Relief as a Defense in Collection Proceedings and Bankruptcy Cases*, *supra*. For this reason, the National Taxpayer Advocate recommends clarifying that the scope and standard of review are *de novo* in innocent spouse cases before the Tax Court “or other court of competent jurisdiction,” thereby precluding any implication that the Tax Court has exclusive jurisdiction over innocent spouse claims. See *Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is De Novo*, *supra*.

**Legislative Recommendation #52****Fix the Donut Hole in the Tax Court's Jurisdiction to Determine Overpayments by Non-Filers With Filing Extensions****PRESENT LAW**

IRC § 6511(a) provides that the limitations period for filing a claim for refund generally expires two years after paying the tax or three years after filing the return, whichever is later. The amount a taxpayer can recover is limited to amounts paid within the applicable lookback period provided by IRC § 6511(b)(2). If the claim was filed within three years of the return, then the lookback period is three years, plus any filing extension. If the claim wasn't filed within three years of the return or the taxpayer never filed a return, the lookback period is two years.

When a taxpayer does not file a return, the IRS sometimes sends a notice of deficiency to assess additional tax. A notice of deficiency gives the taxpayer the right to petition the United States Tax Court, and if the taxpayer timely does so, then the Tax Court generally has jurisdiction under IRC § 6512(b) to determine whether the taxpayer is due a refund for the taxable year at issue, provided the tax was paid within the applicable lookback period under IRC § 6511(b). Under IRC § 6512(b), if the taxpayer did not file a return before receiving the notice of deficiency, the date on the notice of deficiency becomes the hypothetical date of the taxpayer's refund claim, and the two- or three-year lookback period in IRC § 6511(b)(2) runs from the date the IRS mailed the notice of deficiency. Absent a special rule, the Tax Court would have no jurisdiction to award refunds to non-filers who are issued a notice of deficiency more than two years after paying the tax.

However, the flush language of IRC § 6512(b)(3) provides just such a rule. It says that certain taxpayers who do not file a tax return are entitled to a three-year look-back period. Before Congress amended IRC § 6512 to add this special rule, a taxpayer who had not filed a return before the IRS mailed a notice of deficiency was entitled only to a two-year lookback period. But Congress, seeking to extend the lookback period available to such non-filing taxpayers, provided that if a notice of deficiency is mailed "during the third year after the due date (with extensions) for filing the return," and if no return was filed before the notice of deficiency was mailed, the lookback period is three years.

This special rule contains an unintended glitch. In the case of a non-filer who had requested an extension of time to file and then received a notice of deficiency, the words "with extensions" could delay by six months the beginning of the "third year after the due date." As a result, if the IRS mailed a notice of deficiency before the beginning of the third year, the Tax Court would not have jurisdiction to look back more than two years from the notice of deficiency, and thus would not be able to consider any overpayment that had been paid on the original due date of the return, usually April 15. Thus, there is a six-month "donut hole" during which the IRS can send a notice of deficiency without triggering the Tax Court's jurisdiction to consider the taxpayer's claim for refund.

An example may help to illustrate these rules. Assume John Doe had made estimated tax payments in excess of his tax liability by April 15, 2016, the original filing deadline for a 2015 tax return. He had requested a six-month extension of time to file but did not file a return. On July 2, 2018, the IRS mailed him a notice of deficiency for the 2015 tax year. He responded to the notice by petitioning the Tax Court and explaining the notice was incorrect because he had paid the asserted deficiency. He then filed a tax return showing he

had overpaid his tax and was due a refund. Under the flush language of IRC § 6512, the Tax Court can only refund payments made within two years of the date on the notice of deficiency, without regard to extensions (*i.e.*, for taxes paid on or after July 2, 2016). The special rule (flush language of IRC § 6512(b)(3)) would not help Mr. Doe because the notice of deficiency was mailed on July 2, 2018.

The special rule would only apply if the IRS had mailed the notice of deficiency during the third year after the due date of his return (with extensions) (*i.e.*, the year beginning after October 15, 2018). Because the IRS mailed his notice of deficiency before the third year had begun, the special rule did not apply, and John Doe could not get his refund.

## REASONS FOR CHANGE

According to the legislative history, Congress enacted the special rule of IRC § 6512(b)(3) to put non-filers who receive notices of deficiency after the two-year lookback period on the same footing as taxpayers who file returns on the same day the IRS mailed the notice of deficiency. The special rule was supposed to allow non-filers “who receive a notice of deficiency and file suit to contest it in Tax Court during the third year after the return due date, to obtain a refund of excessive amounts paid within the 3-year period prior to the date of the deficiency notice.”<sup>1</sup>

However, the statute as written may not fix the problem it was enacted to solve. In *Borenstein*, the Tax Court concluded that it had no jurisdiction to determine a non-filer’s overpayment because the non-filer had requested a six-month extension to file and the IRS mailed the notice of deficiency during the first six months of the third year following the original due date — after the second year following the due date (without extensions) and before the third year following the due date (with extensions).<sup>2</sup> Thus, the court found that the special rule of IRC § 6512(b)(3) leaves a donut hole in its jurisdiction. Although the U.S. Court of Appeals for the Second Circuit reversed the Tax Court’s decision, the Tax Court is not required to follow the Second Circuit’s decision in cases arising in other circuits.<sup>3</sup> Thus, unless the Tax Court revisits its decision, a legislative fix is still needed.

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

1 H.R. REP. NO. 105-220, at 701 (1997) (CONF. REP.).

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

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

**RECOMMENDATION<sup>4</sup>**

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

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4 For more detail, see National Taxpayer Advocate 2018 Annual Report to Congress (Legislative Recommendation: *Tax Court Jurisdiction: Fix the Donut Hole in the Tax Court's Jurisdiction to Determine Overpayments by Non-Filers With Filing Extensions*); Nina E. Olson, *The Second Circuit in Borenstein Helped to Close the Gap in the Tax Court's Refund Jurisdiction, but Only for Taxpayers in that Circuit*, NATIONAL TAXPAYER ADVOCATE BLOG, <https://www.taxpayeradvocate.irs.gov/news/ntablog-the-second-circuit-in-borenstein-helped-to-close-the-gap-in-the-tax-courts-refund-jurisdiction-but-only-for-taxpayers-in-that-circuit/> (Apr. 27, 2019). This recommendation could be implemented by revising the flush language in IRC § 6512(b)(3) to insert the word "original" before "due date" and striking the parenthetical phrase "(with extensions)."