

Legislative Recommendation #48**Repeal *Flora*: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can****PRESENT LAW**

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

If a taxpayer does not receive a notice of deficiency or lets the period for filing a petition with the U.S. Tax Court lapse, the taxpayer must file suit in a U.S. district court or the U.S. Court of Federal Claims to obtain judicial review of an adverse IRS determination. This generally occurs when the taxpayer is claiming a refund of tax that has been paid. It may also occur when the IRS has imposed certain “assessable penalties” (*e.g.*, penalties codified in IRC §§ 6671-6725), without first issuing a notice of deficiency. In these circumstances, the taxpayer generally must pay the full amount of the tax due, or any penalty assessed, prior to seeking judicial review via a refund suit.

Before filing a refund suit, a taxpayer must make a timely administrative claim for refund.¹ The IRC 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.² If the claim is filed within the three-year period, then the taxpayer can only recover amounts paid during the three-year period (plus any extension of time to file) preceding the date of the claim.³ Otherwise, the taxpayer can only recover amounts paid within the two-year period preceding the date of the claim.⁴ If the IRS issues a notice of claim disallowance, a taxpayer generally has two years from the date of the notice within which to file suit; the two-year period can be extended upon written agreement between the taxpayer and the IRS.⁵ If the IRS does not issue a notice of claim disallowance, the taxpayer may file suit beginning six months after filing a refund claim.⁶

A taxpayer may sue in a U.S. district court or the U.S. Court of Federal Claims under 28 U.S.C. § 1346(a)(1) to recover “any internal-revenue tax” that the taxpayer believes has 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 under the internal-revenue laws.” In *Flora v. United States*, 362 U.S. 145 (1960), however, the U.S. Supreme Court held that, with limited exceptions, a taxpayer must have “fully paid” the assessment (called the “full payment rule”) before suing in these courts.

IRC § 7421 (the Anti-Injunction Act) prohibits any suit by any person for the purpose of restraining the assessment or collection of any tax except as provided in IRC §§ 6015(e), 6212(a) and (c), 6213(a), 6232(c), 6330(e)(1), 6331(i), 6672(c), 6694(c), 7426(a) and (b)(1), 7429(b), and 7436. In addition, 28 U.S.C. § 2201 (also known as the “tax exception” to the Declaratory Judgment Act) states in relevant part that federal courts may not issue declaratory judgments “with respect to Federal taxes” other than in actions brought under IRC § 7428 relating to status and classification of certain organizations (such as under section 501(c)(3)).

1 IRC § 7422(a).

2 IRC § 6511(a).

3 IRC § 6511(b)(2)(A).

4 IRC § 6511(b)(2)(B).

5 IRC § 6532(a)(1) & (2).

6 IRC § 6532(a)(1).

REASONS FOR CHANGE

Consistent with the taxpayer's *right to appeal an IRS decision in an independent forum*, all taxpayers should generally have an opportunity to take their cases to court.⁷ Taxpayers who cannot afford to pay what the IRS says they owe should have the same opportunities to choose a judicial forum as wealthier taxpayers who can afford to pay.

Under current law, wealthy individuals and corporations typically may choose between paying the tax and litigating their cases in a U.S. district court or the Court of Federal Claims or not paying the tax and litigating in the Tax Court. They may select the court with the precedents and procedures most favorable to their position from among these three options. Taxpayers who cannot afford to pay the tax only have one option – the Tax Court. While the Tax Court is often the easiest court for taxpayers to navigate, there is no reason some taxpayers should have more options than others.

U.S. Tax Court Judge Howard Dawson once observed:

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?⁸

As eloquently stated by Judge Dawson, we should not have a system that provides more benefits for the wealthy – access to more federal courts – than those less fortunate. Allowing all taxpayers to file suit in the judicial forum of their choice would be fairer to all taxpayers.

Under existing rules, the inability to litigate in the Tax Court can create extreme burdens. If the IRS imposes an “assessable penalty,” no notice of deficiency is issued, so the Tax Court is not authorized to hear a dispute. Therefore, a taxpayer may obtain judicial review only if he or she is wealthy enough to full pay the penalty and then sue for a refund.⁹ In addition, even taxpayers who fully pay may lose the opportunity to recover a portion of their payments if they pay in installments. For example, if a taxpayer does not file a refund claim within three years from the date the original return was filed, the taxpayer can only recover amounts paid within two years before the date of the claim. In this situation, a taxpayer who is not affluent enough to pay his or her alleged debt within two years will lose the right to request a refund of the early payments, even if he or she eventually pays in full and the court agrees with him or her on the merits of the refund claim.

Although the Supreme Court once feared that giving the relatively few wealthy persons subject to tax the option to litigate rather than pay could threaten the solvency of the government, the U.S. tax base is much broader today, and as a result, whether judicial review occurs before or after payment in individual cases is not significant from a budgetary standpoint. The National Taxpayer Advocate recommends that Congress provide all taxpayers with an equal opportunity to choose the judicial forum in which to challenge an adverse IRS

⁷ IRS, Taxpayer Bill of Rights, <https://www.irs.gov/taxpayer-bill-of-rights>.

⁸ Howard Dawson, *Should the Federal Tax Litigation System Be Restructured?*, 40 TAX NOTES 1427 (2000).

⁹ For a legislative recommendation to require the IRS to follow deficiency procedures before assessing certain penalties, see Legislative Recommendation: Amend IRC § 6212 to Provide That the Assessment of Foreign Information Reporting Penalties Under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D Is Subject to Deficiency Procedures, *supra*.

determination without regard to their ability to pay. This recommendation aims to provide all taxpayers with an opportunity to choose between paying the tax and litigating their cases in a U.S. district court or the Court of Federal Claims and not paying the tax and litigating in the Tax Court. Removing the full payment rule would allow all taxpayers to file refund suits and have an opportunity to have their issues heard, regardless of whether they have the money to pay the liability.

RECOMMENDATION¹⁰

- Amend 28 U.S.C. § 1346(a)(1) to 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 (*i.e.*, repeal the *Flora* Court’s full payment rule), notwithstanding any provisions of IRC § 7421(a) and 28 U.S.C. § 2201(a) to the contrary.¹¹

¹⁰ For more detail, see National Taxpayer Advocate 2021 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 94-97 (*Repeal Flora and Expand the Tax Court’s Jurisdiction, Giving Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*); National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 82-84 (*Repeal Flora: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*); 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*).

¹¹ 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.*, Chief Counsel Directives Manual 34.5.1.1.2.2.4 (Aug. 11, 2004).