

STRENGTHEN TAXPAYER RIGHTS IN JUDICIAL PROCEEDINGS

Legislative Recommendation #43

Expand the U.S. Tax Court's Jurisdiction to Hear Refund Cases

SUMMARY

- *Problem:* For most taxpayers, the U.S. Tax Court is the optimal court in which to challenge an adverse IRS decision because payment is not a requirement for jurisdiction and the judges possess specialized tax expertise. Under current law, however, taxpayers generally may litigate their tax liabilities in Tax Court only if the IRS determines a taxpayer owes more tax and it issues a notice of deficiency. When taxpayers are solely seeking refunds because they believe they overpaid their tax, they are barred from the Tax Court and must litigate their claims in other less user-friendly and more costly federal courts.
- *Solution:* Expand the Tax Court's jurisdiction to determine tax liabilities and refunds in refund cases.

PRESENT LAW

IRC § 7442 defines the jurisdiction of the U.S. 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 United States) to review the IRS determination.

If a taxpayer does not receive a notice of deficiency and seeks judicial review of an adverse IRS determination, the taxpayer must pay the tax, penalty, or interest and file suit in a U.S. district court or the U.S. Court of Federal Claims. This situation generally arises when the taxpayer is claiming a refund of tax, penalty, or interest that has been paid. Taxpayers solely seeking refunds of monies already paid cannot litigate their cases in the Tax Court.

REASONS FOR CHANGE

Due to the tax expertise of its judges, the Tax Court is often better equipped to consider tax controversies than other courts. It is also more accessible to less knowledgeable and unrepresented taxpayers than other courts because it offers simplified and less formal procedures, particularly for disputes that do not exceed \$50,000. Another benefit is that low-income taxpayers representing themselves are generally offered the option of receiving free legal assistance from a Low Income Taxpayer Clinic or *pro bono* representative. In most instances, the Tax Court is the least expensive and best forum for low-income taxpayers to get their day in court.

Under current law, taxpayers who receive a notice of deficiency and wish to challenge the IRS's proposed adjustment can file a petition in the Tax Court, while taxpayers who have paid their tax and are seeking a refund must sue for a refund in a U.S. district court or the U.S. Court of Federal Claims to obtain a judicial determination. The National Taxpayer Advocate recommends that all taxpayers bringing refund suits be given the option to litigate their tax disputes in the Tax Court.

Two examples will illustrate the benefits of this approach:

Example 1: A taxpayer files a return that reflects a tax liability of \$15,000. The taxpayer had \$12,000 of withholding and pays an additional \$3,000 with the return. Shortly after filing the original return, the taxpayer's preparer discovers an error, and the taxpayer files an amended return showing a tax liability of \$11,000 and claiming a refund of \$4,000. The IRS denies the claim. Under current law, the taxpayer cannot go to Tax Court because there is no deficiency (*i.e.*, the IRS has not determined that any additional tax is due). To litigate the refund claim, the taxpayer will have to file a refund suit in a U.S. district court or the U.S. Court of Federal Claims to pursue the \$4,000 refund claim. This taxpayer is harmed because refund suits involve greater cost and more formal court proceedings, and they are likely to require representation by an attorney.

Example 2: The IRS imposes an assessable penalty on a taxpayer of \$10,000. If the taxpayer was unsuccessful in challenging the penalty administratively, the taxpayer will have to pay the penalty and file a refund suit in a U.S. district court or the U.S. Court of Federal Claims. Because no notice of deficiency is issued in this case, no action can be brought in the Tax Court. Again, the taxpayer will have to pay the higher court fees and will probably have to retain an attorney to effectively dispute the assessment. If the taxpayer can bring a refund suit in the Tax Court, a judge with tax expertise will hear the case and the Tax Court's simplified procedures might allow the taxpayer to proceed *pro se* (*i.e.*, without a representative). This may make the difference between the taxpayer having their day in court or the taxpayer agreeing to an assessment simply because the costs of contesting it are too great.

By expanding the Tax Court's jurisdiction, Congress can give all taxpayers a better opportunity to obtain judicial review of adverse IRS liability determinations.

RECOMMENDATION

- 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.¹

¹ For a related recommendation that would allow taxpayers to challenge assessable penalties in the Tax Court, see *Provide That Assessable Penalties Are Subject to Deficiency Procedures, supra*. Based on existing law and procedures, the IRS Office of Chief Counsel represents the government in Tax Court cases, and the Justice Department's Tax Division represents the government in cases before a U.S. district court or the U.S. Court of Federal Claims. If the Tax Court's jurisdiction is expanded and some cases shift toward the Tax Court, the number of attorneys representing the government in each agency may require adjustment.