

Legislative Recommendation #50**Fix the Donut Hole in the Tax Court’s Jurisdiction to Determine Overpayments by Non-Filers With Filing Extensions****SUMMARY**

- *Problem:* A “donut hole” in the Tax Court’s jurisdiction prevents it from reviewing some taxpayer refund claims. This unusual situation arises when taxpayers overpay their tax obligations, receive a six-month filing extension but do not file a return, and later receive a notice of deficiency from the IRS. The Tax Court’s jurisdiction to review refund claims in these circumstances is uncertain, which harms taxpayers.
- *Solution:* Amend IRC § 6512(b)(3) to clarify that the Tax Court has jurisdiction to review refund claims by taxpayers affected by the existing “donut hole.”

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 a taxpayer files a claim within three years of the original return, the lookback period is three years, plus any filing extension. If a taxpayer does not file a claim within three years of the return or the taxpayer never filed a return, the lookback period is two years. IRC § 6513(b) provides that withholding and amounts paid as estimated tax are deemed paid on the original due date of the return, which means taxpayers who have overpaid generally cannot claim a refund more than two years later unless they file a return.

When the IRS proposes to assess additional tax, it ordinarily must issue a notice of deficiency to the taxpayer, who can then seek review in the U.S. Tax Court if they disagree with the IRS’s position.¹ If the taxpayer files a timely petition, the Tax Court generally has jurisdiction under IRC § 6512(b) to determine whether the taxpayer is due a refund for the tax year at issue. The refund is limited to the tax paid within a specified period. The relevant period here is described in IRC § 6512(b)(3)(B), which limits the refund to tax paid during the applicable two- or three-year lookback period in IRC § 6511(b)(2), running from the date the IRS mailed the notice of deficiency.

In 1996, the Supreme Court held in *Commissioner v. Lundy* that the language in IRC § 6512(b)(3)(B) meant that the two-year lookback period applied to a taxpayer who had not filed a return before the IRS mailed a notice of deficiency.² The IRS had mailed the notice in the third year after the return’s filing deadline, and the Court determined that the taxpayer was unable to recover overpayments from withholding since they were deemed paid on the original due date of the return, which was more than two years from the date of the notice of deficiency.

The Supreme Court’s interpretation created a disparity between non-filers who received notices of deficiency during the third year after the return was due and taxpayers who similarly received such a notice but had filed returns on or before the notice’s date. Non-filers were subject to the two-year lookback period and thus unable to recover overpayments attributable to withholding and estimated taxes because those amounts were deemed paid on the due date of the return, which was outside the two-year window. By contrast, filers were subject

¹ IRC §§ 6212, 6213.

² 516 U.S. 235 (1996).

to the three-year lookback period and could be refunded those overpayments. In 1997, Congress added flush language to IRC § 6512(b)(3) to eliminate the disparity by extending the lookback period for non-filing taxpayers from two years to three years when the IRS mailed the notice of deficiency “during the third year after the due date (with extensions) for filing the return.”³

REASONS FOR CHANGE

The 1997 law may not entirely fix the problem it was enacted to solve. According to the legislative history, Congress enacted the special rule of IRC § 6512(b)(3) to put non-filers who receive notices of deficiency within three years after the date the return was due on the same footing as taxpayers who file returns on or before the IRS mails 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 three-year period prior to the date of the deficiency notice.”⁴

In 2017, the Tax Court interpreted the law in a way that has created a jurisdictional “donut hole” for taxpayers who filed for an extension but did not subsequently file their return. In *Borenstein v. Commissioner*, the Tax Court concluded that it lacked jurisdiction to determine a non-filer’s overpayment because the non-filer had requested a six-month extension to file and the IRS had mailed the notice of deficiency during the first six months of the third year following the original due date – *i.e.*, after the second year following the due date (without extensions) and before the third year following the due date (with extensions).⁵ Under the Tax Court’s reading of the statute, the words “with extensions” can delay by six months the beginning of the “third year after the due date” for non-filers who received filing extensions but do not file and who then receive a notice of deficiency from the IRS.

This unintended glitch opens a six-month “donut hole” during which the IRS can send deficiency notices to taxpayers without triggering the Tax Court’s jurisdiction to consider the refund claims of those taxpayers. 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.⁶ Thus, unless the Tax Court revisits its own precedent, a legislative fix is still needed.

Example: For tax year 2018, John Doe made timely estimated tax payments in excess of his tax liability, so the tax was deemed paid on April 15, 2019. He requested a six-month extension of time to file his return, but he ultimately did not file. On July 2, 2021, the IRS mailed him a notice of deficiency for the 2018 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. Because Mr. Doe did not file a return previously, the general rule of IRC § 6512 limits the Tax Court to refunding 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, 2019). This rule would not help Mr. Doe because he paid his taxes on April 15, 2019, which is more than two years before the date of the notice of deficiency.

3 Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1282(a), 111 Stat. 788, 1037 (1997); H.R. REP. No. 105-220, at 701 (1997) (Conf. Rep.).

4 H.R. REP. No. 105-220, at 701 (1997) (Conf. Rep.).

5 *Borenstein v. Comm’r*, 149 T.C. 263 (2017), *rev’d*, 919 F.3d 746 (2d Cir. 2019). See also *O’Connell v. Comm’r*, No. 6587-20 (T.C. May 20, 2021) (settled in accordance with the *Borenstein* precedent).

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

Under the Tax Court’s interpretation of the statute, the flush language in IRC § 6512 also would not help Mr. Doe, because it 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, 2021). 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.

This glitch arises when the IRS issues a notice deficiency after the regular filing deadline (generally, April 15) and not later than the extended filing deadline (generally, October 15) if the taxpayer requested an extension but did not file a return.

The Tax Court’s interpretation appears inconsistent with the legislative fix that Congress enacted to assist certain non-filers in response to *Lundy*. Although this problem affects a relatively limited number of taxpayers, the National Taxpayer Advocate believes it is important to highlight the unintended glitch and recommend a solution.⁷

RECOMMENDATION

- Amend the flush language in IRC § 6512(b)(3) by inserting the word “original” before “due date” and striking the parenthetical clause “(with extensions).”

⁷ For more detail, see 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 (Apr. 24, 2019), <https://www.taxpayeradvocate.irs.gov/news/nta-blog/ntablog-the-second-circuit-in-borenstein-helped-to-close-the-gap-in-the-tax-courts-refund-jurisdiction-but-only-for-taxpayers-in-that-circuit/2019/04>.