Significant Cases

This section describes cases that generally do not involve any of the ten most litigated issues, but nonetheless highlight important issues relevant to tax administration.[1] These decisions are summarized below.

In *Larson v. United States*, the U.S. Court of Appeals for the Second Circuit held that it lacked jurisdiction to review assessable penalties under 28 U.S.C. § 1346(a) because the taxpayer had not fully paid them, as required under the *Flora* rule, and also lacked jurisdiction under the Administrative Procedure Act (APA).[2]

Following Mr. Larson's conviction for promoting tax shelters, the IRS proposed over $160 million in civil penalties under IRC § 6707 for failure to timely register the shelters. The IRS's Appeals function reduced the penalty by the amounts paid by alleged co-promoters who were jointly and severally liable, leaving an assessment of over $65 million. Mr. Larson could not pay the full assessment, so he only paid about $1.4 million. He then filed a refund claim, which the IRS rejected.

Mr. Larson petitioned the U.S. District Court for the Southern District of New York. The court granted the IRS's motion to dismiss because Mr. Larson had not fully paid the assessment, as required by the *Flora* rule (also called the "full payment" rule).[3] In 1960, the Supreme Court held in *Flora* that because the government had waived its sovereign immunity under 28 U.S.C. § 1346(a)(1) only with respect to refund claims that were fully paid, it lacked jurisdiction to review unpaid or partially paid claims.[4]

Mr. Larson appealed, arguing that: (1) the full payment rule only applies in deficiency cases, such as *Flora*, that could have been brought in the U.S. Tax Court before being paid; (2) the full payment rule violates his Fifth Amendment right to due process because he cannot fully pay and seek review; (3) the Administrative Procedure Act (APA) grants jurisdiction because there are no other avenues for judicial review; and (4) the penalty violates the excessive fines clause of the Eighth Amendment.

The U.S. Court of Appeals for the Second Circuit said that because 28 U.S.C. § 1346(a)(1) does not distinguish between deficiencies and assessable penalties, both are subject to the full payment rule. It observed that following the enactment of 28 U.S.C. § 1346(a), Congress provided limited exceptions to the rule for some penalties (*e.g.*, IRC §§ 6694(c) and 6703(c)), but not for the penalties at issue.

While acknowledging that the *Flora* decision had assumed the full payment rule would not result in hardship because taxpayers could "appeal the deficiency to the Tax Court without paying a cent,"[5] the Second Circuit said the availability of Tax Court review was not essential to the *Flora* court's

1 When identifying the ten most litigated issues, TAS analyzed federal decisions issued during the period beginning on June 1, 2017, and ending on May 31, 2018. For purposes of this section, we used the same period.

2 *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 and rehearing en banc filed*, Docket No. 16-CV-00245 (June 8, 2018).

3 *Flora v. United States* (*Flora*), 362 U.S. 145 (1960), *reaff'g Flora v. United States*, 357 U.S. 63 (1958). Mr. Larson may have paid $1.4 million because he thought he was fully paying a "divisible" portion of the penalty, which could trigger jurisdiction under *Flora*, 362 U.S. at 175, n. 37-38. A penalty is divisible if portions can be allocated to separate transactions or violations. After he filed suit, however, the Federal Circuit held in *Diversified Group Inc. v. United States*, 841 F.3d 975 (Fed. Cir. 2016), that the penalty under IRC § 6707 is not divisible.

4 28 U.S.C. § 1346(a)(1) grants jurisdiction "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 under the internal-revenue laws."

5 *Flora*, 362 U.S. at 175.

conclusion.[6] Rather, *Flora* was based on Congress's understanding that full payment was required, as evidenced by the statutory scheme that Congress fashioned around 28 U.S.C. § 1346(a).[7] *Flora* did not rewrite the statute to engraft the requirement that an alternate forum be available, according to the court.[8]

Next, the Second Circuit evaluated Larson's due process claims. In evaluating such claims, courts consider three factors: (1) the private interest that will be affected by the official action; (2) the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and (3) the government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.[9] After weighing these factors, the court concluded that the full payment rule did not violate Mr. Larson's right to due process because of his opportunity to be heard by the IRS Office of Appeals, which had reduced the assessment, and the government's interest in protecting the public purse.[10]

Finally, the Second Circuit concluded it had no jurisdiction under the APA. By providing an exception to the full payment rule for some penalties but not others, Congress had implicitly precluded prepayment review. Even if it had not implicitly precluded prepayment review, it provided specific and adequate review procedures by providing for post-payment review, according to the court.[11] Although Mr. Larson cited cases in which other courts found post-payment review inadequate, the court distinguished them as involving challenges to regulations or claims of bad faith. Moreover, the court observed that Mr. Larson's case was reviewed by Appeals.[12]

6 *Larson*, 888 F.3d at 582. Supreme Court Justice Blackmun had interpreted *Flora* as indicating that "the full-payment rule applies only where… the taxpayer has access to the Tax Court for redetermination prior to payment," but the Second Circuit explained that Justice Blackmun's view did not garner majority support. *Larson*, 888 F.3d at 582, n.8 (citing *Laing v. United States*, 423 U.S. 161, 208-209 (1976) (Blackmun, J., dissenting)). Critics have pointed out that the Second Circuit brushed off the fact that the majority did not disagree with J. Blackmun on this point and that the Solicitor General made the same argument. *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).

7 *Larson*, 888 F.3d at 582.

8 *Id*. The Supreme Court had remarked in *Flora* that it was vexed by "statutory language [of § 1346(a)] which is inconclusive and legislative history which is irrelevant." *Flora*, 362 U.S. at 152. This may suggest that the Supreme Court felt it was, in fact, rewriting an inconclusive statute.

9 *Mathews v. Eldridge*, 424 U.S. 319, 335 (1976).

10 The court mentioned the "public purse," "efficient administration," and the "government need … [to promptly] secure its revenues" as justifications for the lack of a pre-payment forum for judicial review of an assessable tax penalty, quoting an old case that cited older decisions that expressed concerns, which carried more force before 1913. *See Larson*, 888 F.3d at 583-584 (*quoting Phillips v. Comm'r*, 283 U.S. 589, 595-96 (1931) (citing *Cheatham v. United States*, 92 U.S. 85, 89 (1876) (worrying the "very existence of the government might be placed in the power of a hostile judiciary" if taxpayers could dispute liabilities before paying))). Before 1913 when the 16th Amendment was ratified, there were legitimate concerns that a "hostile judiciary" would block the federal government from collecting various taxes, such as the income tax, which the Supreme Court had held was largely unconstitutional. *See Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895). By 1924 such concerns must have subsided because Congress authorized pre-payment review of most tax deficiencies by a predecessor of the Tax Court. Revenue Act of 1924, 43 Stat. 253, 297-336 (1924). However, the court did not revisit the underlying analysis. 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).

11 The court also noted that the Anti-Injunction Act (AIA) bars APA claims unless there is no alternative avenue for judicial review. *Larson*, 888 F.3d at 585, n.11.

12 Critics have argued that the opportunity to present a case to the IRS's Appeals function does not provide sufficient due process. *See, e.g.*, Lawrence Hill & Richard Nessler, *IRS Penalty Assessments Without Due Process?*, 159 Tax Notes 1763 (June 18, 2018).

Because the court had no jurisdiction, it did not evaluate whether the penalty violated the excessive fines clause of the Eighth Amendment. The court acknowledged that a $61 million penalty assessment that is not subject to judicial review unless the taxpayer fully pays it "seems troubling," particularly where the taxpayer cannot pay.[13] But, the court remarked that "it is Congress' responsibility to amend the law."[14]

This case is significant because it highlights that taxpayers do not have the unabridged right to judicial review, especially when the IRS's penalty determination is so severe or the taxpayer is so poor that the assessment cannot be paid.[15] This report includes a specific legislative recommendation to address the problems highlighted by this case.[16]

In *United States v. Stein*, the U.S. Court of Appeals for the Eleventh Circuit held a taxpayer's affidavit may create an issue of material fact sufficient to preclude summary judgment in a collection case even if it is self-serving and uncorroborated, notwithstanding the presumption of correctness afforded to IRS assessments.[17]

In 2015, the government sued Ms. Stein in district court to collect approximately $220,000 in unpaid tax assessments, late penalties, and interest owed for tax years 1996, 1999, 2000, 2001, and 2002.[18] The government introduced her tax returns and account transcripts, but had not deposed Ms. Stein.

In response, Ms. Stein offered a sworn affidavit which listed the amounts she owed and paid for a number of years, including specific amounts the IRS acknowledged that it had misapplied, and declared "[I]t is my unwavering contention that I paid the taxes due, including late filing penalties, at such time as I filed the returns for each of the tax years in question."[19] The district court granted the IRS's motion for summary judgment because it said that self-serving assertions cannot rebut the presumption of correctness given to tax assessments under *Mays v. United States*.[20]

A panel of the U.S. Court of Appeals for the Eleventh Circuit affirmed,[21] but after reconsidering the case *en banc*, the court vacated the panel's decision and overruled *Mays*. It reasoned that Federal Rule of Civil Procedure (FRCP) 56(a) authorizes summary judgment only when "there is no genuine dispute as to any material fact" and the moving party is "entitled to judgment as a matter of law," rather than a trial by jury. Because the nonmoving party can dispute a material fact using an affidavit under FRCP 56(c), an affidavit can be enough to permit the case to survive summary judgment.

Although an affidavit cannot be conclusory, it can be self-serving and based solely on personal knowledge or observation. Such affidavits are routinely used to defeat summary judgment. The court reasoned there is no basis to treat affidavits in tax cases any differently under FRCP 56. Thus, it held

13 *Larson*, 888 F.3d at 587.

14 *Id.* (internal quotation omitted).

15 The court did not discuss the "right to appeal a decision of the Internal Revenue Service in an independent forum" under IRC § 7803(a)(3)(D).

16 *See* Legislative Recommendation: Fix the *Flora* Rule: *Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*, *supra*.

17 *United States v. Stein*, 881 F.3d 853 (11th Cir. 2018).

18 District courts have jurisdiction under IRC § 7402(a) to "render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws."

19 *Stein*, 881 F.3d at 856.

20 763 F.2d 1295, 1297 (11th Cir. 1985).

21 *United States v. Stein*, 840 F.3d 1355 (11th Cir. 2016), *aff'g* 117 A.F.T.R.2d (RIA) 800 (S.D. Fla. 2016).

that a non-conclusory affidavit which complies with FRCP 56 can create a genuine dispute concerning an issue of material fact, even if it is self-serving and uncorroborated.[22]

The Eleventh Circuit cautioned, however, that a self-serving and uncorroborated affidavit would not always preclude summary judgment. Although *Mays* was a refund case, the court also cautioned that it was not expressing a view as to whether something other than uncorroborated oral testimony would be necessary to withstand summary judgment in a tax refund case.[23]

This case is significant because it may prompt the IRS to solicit and consider the taxpayer's position before filing a collection suit, even if the taxpayer's position includes statements that are self-serving and uncorroborated. Such an outcome would be consistent with several taxpayer rights, including the rights *to pay no more than the correct amount of tax* and *to challenge the IRS position and be heard*.[24] Indeed, this case has already prompted other courts to reject the IRS's motion for summary judgment where the IRS has declined to consider the taxpayer's position.[25]

In *Chamber of Commerce v. IRS*, the U.S. District Court for the Western District of Texas held that the Anti-Injunction Act (AIA) did not bar a pre-enforcement challenge to a temporary regulation, and the temporary regulation was invalid because the IRS did not comply with the APA's notice and comment requirements.[26]

In April 2016, the IRS issued both temporary and proposed regulations to inhibit inversions.[27] The plaintiffs argued the regulations exceeded the IRS's statutory authority, were arbitrary and capricious, and were issued without notice and opportunity for comment in violation of the APA.[28] The IRS argued the plaintiffs lacked standing and that the suit was barred by the AIA.[29]

First, the court held that the plaintiff associations had standing because Allergan, which was one of their members, had standing. Allergan had standing because it was injured by the regulations. Allergan had agreed to merge with Pfizer under the assumption that the combined company would not be subject to tax in the U.S. (*i.e.*, it was an inversion). The court found that the regulations were promulgated, in part, to prevent the Pfizer-Allergan inversion, which they did, and Allergan was facing continuing injury because it would have pursued other inversions but for the regulations. It did not need to engage in negotiations for deals that were economically impracticable just so that it could establish standing.

22 A thoughtful concurrence by Justice Pryor framed the historical context of the decision. *See Stein*, 881 F.3d at 859-860 (Pryor, J., concurring). He noted that after hearing that local juries in America were rendering biased decisions in customs litigation, the British Parliament shifted revenue litigation to courts sitting without juries. This led the colonists to adopt the Seventh Amendment right to a jury trial in civil cases. Therefore, he noted that *Mays* had "ousted the jury from its historical role in the exact context—the enforcement of tax laws—that prompted the founding generation to adopt the Seventh Amendment in the first place." *Id*. at 860.

23 *Stein*, 881 F.3d at 858, n.2.

24 *See* IRC § 7803(a)(3).

25 *See, e.g.*, *McClendon v. United States*, No. 17-20174, 2018 U.S. App. LEXIS 16030 (5th Cir. June 14, 2018); *United States v. Wilkins*, No. 8:14-CV-993-EAK-JSS, 2018 WL 1988872 (M.D. Fla. Mar. 2, 2018).

26 *Chamber of Commerce v. IRS*, No. 1:16-cv-944-LY, 2017 WL 4682050 (W.D. Tex. Oct. 6, 2017).

27 Treas. Reg. § 1.7874-8T; Prop. Treas. Reg. § 1.7874-8; *Inversions and Related Transactions*, 81 Fed. Reg. 20,588-591 (Apr. 8, 2016).

28 *See* 5 U.S.C. § 706.

29 *See* IRC § 7421.

Next, the court held the AIA did not bar the suit. The AIA precludes taxpayers from filing "suit for the purpose of restraining the assessment or collection of any tax."[30] The court concluded that the plaintiffs were challenging the validity of a temporary regulation governing who is subject to taxation under the IRC. It reasoned that the AIA does not insulate from challenge every rule that might eventually assist the government in assessing or collecting a tax. Enforcement of the regulation would precede any assessment or collection of tax.

The court quoted from the Supreme Court's analysis in *Direct Marketing*, which held that the Tax Injunction Act (TIA), a state analogue to the AIA, did not bar a pre-enforcement challenge to a Colorado law, which required out-of-state retailers to report purchases by Colorado customers.[31] *Direct Marketing* analyzed whether enforcement of the reporting requirements was an act of assessment or collection as those terms are used in the IRC. Because it was not, the TIA did not apply. By analogy, because enforcement of the anti-inversion regulations was not an act of assessment or collection, the court concluded that the AIA did not bar a pre-assessment challenge to them.

In addition, the court held that the temporary regulations were invalid because the IRS failed to comply with the notice and comment requirements of the APA. The APA generally requires agencies to publish a notice of proposed rulemaking in the Federal Register and give interested persons an opportunity to comment at least 30 days before the effective date.[32] However, the temporary regulations were effective immediately.

First, the IRS argued that the temporary regulations were exempt from the notice and comment requirement under IRC § 7805(e) and its legislative history. According to the IRS, Congress's intention was to codify the practice of allowing temporary regulations to be effective immediately (*i.e.*, before notice and comment). However, IRC § 7805(e) merely states that "[a]ny temporary regulation issued by the Secretary shall also be issued as a proposed regulation." Further, the APA provides that a "[s]ubsequent statute may not be held to supersede or modify [the notice-and-comment procedure] ... except to the extent that it does so expressly."[33]

The court reasoned that IRC § 7805(e) does not expressly provide an exception to the notice and comment procedure, and legislative history cannot override the explicit directives of the APA. Moreover, IRC § 7805(b) places limits on when tax regulations can be effective and does not carve out a special rule for temporary regulations.[34] Thus, the court concluded that IRC § 7805 did not authorize the IRS to modify the notice and comment procedure for temporary regulations.

The IRS also argued that the temporary regulations were exempt (under 5 U.S.C. § 553(b)(3)(A)) from the notice and comment requirement because they were merely "interpretive" and not "legislative," but the court was not convinced. According to the court, legislative rules create law and affect individual rights and obligations, whereas interpretative rules are statements as to what the agency thinks the statute or regulation means. The statute authorized regulations to provide a computation that would trigger the anti-inversion rules, and the temporary regulations provided the substantive adjustments

30 IRC § 7421(a). As the Declaratory Judgment Act (28 U.S.C. § 2201) is generally interpreted as barring the same suits as the AIA (*i.e.*, the statutes are "coterminous"), it is common practice not to analyze them separately.

31 *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124 (2015).

32 5 U.S.C. § 553.

33 5 U.S.C. § 559.

34 IRC § 7805(b) ("[N]o temporary, proposed, or final regulation relating to the internal revenue laws shall apply to any taxable period ending before the earliest of the following dates: ... In the case of any final regulation, the date on which any proposed or temporary regulation to which such final regulation relates was filed with the Federal Register....").

needed to implement the statute.[35] Thus, the court determined they were legislative and not exempt from the notice and comment requirement.[36]

This case is significant because it suggests that rules that are effective immediately (before the agency has proposed the rule and considered public comments) are at greater risk of being challenged and held invalid on the basis that they did not comply with the APA.[37] It is also significant because it interprets the AIA more narrowly than the U.S. Court of Appeals for the District of Columbia Circuit, potentially making it easier to obtain pre-enforcement judicial review of regulations.[38]

In *Facebook, Inc. v. IRS*, the U.S. District Court for the Northern District of California held that Facebook had no enforceable right to take its case to the IRS Office of Appeals and the court had no authority to review the IRS's unexplained decision.[39]

The IRS audited Facebook over a five-year period, interviewing employees, issuing more than 200 requests for documents, and asking it to agree to five extensions of the statutory period of limitations. When Facebook declined to extend the period for a sixth time, the IRS issued a statutory notice of deficiency. Facebook petitioned the Tax Court and asked the IRS to transfer the case to the IRS's independent Appeals function. The IRS refused. It determined that doing so was "not in the interest of sound tax administration," as it was permitted to do by Rev. Proc. 2016-22.[40] It did not explain why.

By way of background, since 1955, the IRS's statement of procedural rules have provided that a taxpayer has the right to an administrative appeal.[41] However, courts have held that the IRS is not bound by its statement of procedural rules.[42] In addition, Rev. Proc. 87-24 clarified that certain IRS officials could "determine that a case, or an issue or issues in a case, should not be considered by Appeals."[43] Subsequently, the Internal Revenue Service Restructuring and Reform Act of 1998 granted taxpayers

35 *Compare* IRC § 7874(c)(6) (authorizing "regulations to treat stock as not stock.") *and* IRC § 7874(a)(2)(B)(ii) (providing a computation) *with* Treas. Reg. § 1.7874-8T(b) (providing a somewhat different computation).

36 The court did not cite the Supreme Court's decision in *Mayo Foundation for Medical Education and Research v. United States*, 562 U.S. 44, 55 (2011), which implied that both interpretive and legislative regulations are entitled to so-called *Chevron* deference if (and maybe only if) they are issued after notice and comment. For a discussion of this issue, see, *e.g.*, Elizabeth Chorvat, *Anti-Inversion Regulation Invalidated in Federal Court*, 157 Tax Notes 401 (Oct. 16, 2017).

37 For helpful analysis, see Andrew Velarde, *Chamber of Commerce Throws Door Open for More Reg Challenges*, 2017 TNT 190-1 (Oct. 3, 2017). The IRS should have been on notice in 2010 that its arguments might not be accepted because a concurring opinion in the Tax Court would have come out the same way. *See* National Taxpayer Advocate 2010 Annual Report to Congress 418, 423 (discussing the concurring opinion in *Intermountain Ins. Serv. of Vail, LLC v. Comm'r*, 134 T.C. 211 (2010), *rev'd by* 2011-1 U.S.T.C. (CCH) ¶50,468 (D.C. Cir. 2011)). Moreover, the IRS could have avoided the effective date problem by merely expressing a "good cause" to make the regulations effective immediately, as permitted under the APA, particularly if the good cause is to "prevent abuse." IRC § 7805(b)(3) expressly states that "[T]he Secretary may provide that any regulation may take effect or apply retroactively to prevent abuse."

38 *See Florida Bankers Assoc. v. U.S. Dep't of Treasury*, 799 F.3d 1065 (D.C. Cir. 2015) (holding the AIA barred a challenge to information reporting regulations). For further discussion of this case, see National Taxpayer Advocate 2016 Annual Report to Congress 415, 418-20 (Most Litigated Issue: *Significant Cases*). For comprehensive analysis that lends support to a narrow interpretation of the AIA, see Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. 1683 (2017).

39 *Facebook, Inc. & Subsidiaries v. IRS*, 2018-1 U.S.T.C. (CCH) ¶50,248 (N.D. Cal. 2018).

40 Rev. Proc. 2016-22, 2016-15 I.R.B. 577, *superseding* Rev. Proc. 87-24, 1987-1 C.B. 720.

41 20 Fed. Reg. 4621, 4626 (June 30, 1955) (codified at 26 C.F.R. § 601.106(b), which provided that if the IRS "has issued a preliminary or '30-day letter'" and the taxpayer has filed a timely protest, "the taxpayer has the right (and will be so advised by the district director) of administrative appeal.").

42 *See Ward v. Comm'r*, 784 F.2d 1424, 1431 (9th Cir. 1986); *Estate of Weiss v. Comm'r*, T.C. Memo. 2005-284 (2005). *But see*, *Richardson v. Joslin*, 501 F.3d 415, 418 (5th Cir. 2007) ("[A]n agency must abide by its own regulations.") (*citing Accardi v. Shaughnessy*, 347 U.S. 260 (1954)); *United States v. Heffner*, 420 F.2d 809 (4th Cir. 1969) (IRS bound by instructions given to Special Agents); *Rauenhorst v. Comm'r*, 119 T.C. 157 (2002) (IRS bound by revenue rulings).

43 Rev. Proc. 87-24, 1987-1 C.B. 720, *superseded by* Rev. Proc. 2016-22, 2016-15 I.R.B. 577.

the statutory right to an administrative appeal in specific circumstances, but did not address whether taxpayers always have the right to an administrative appeal.[44]

In her 2007 Annual Report to Congress and in subsequent reports, the National Taxpayer Advocate recommended that the IRS adopt or that Congress codify a taxpayer bill of rights (TBOR) that included, among other things, the right to an appeal in an independent forum.[45] On June 10, 2014, the IRS adopted the TBOR and incorporated it into Publication 1.[46] On December 18, 2015, the Protecting Americans from Tax Hikes (PATH) Act codified the TBOR.[47] IRC § 7803(a)(3) now provides that the "Commissioner shall ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by *other provisions* of this title, including—… the right to appeal a decision of the Internal Revenue Service in an independent forum." (Emphasis added.)[48]

In late 2015, the IRS requested public comments on procedures that would deny taxpayers the right to go to Appeals if the "referral is not in the interest of sound tax administration," even in cases not designated for litigation.[49] The American Bar Association Section of Taxation suggested the IRS "elaborate and clarify the limited circumstances in which docketed cases will be ineligible to be returned to Appeals due to 'sound tax administration.'"[50] However, the IRS finalized these procedures as Rev. Proc. 2016-22 without addressing this comment. The IRS did not explain why it declined to elaborate on or clarify this standard.[51]

In this case, Facebook responded to the IRS's refusal to refer its case to Appeals by filing suit in district court, alleging the IRS (1) violated its "right to appeal a decision of the Internal Revenue Service in an independent forum," under IRC § 7803(a)(3)(E), and (2) violated the APA when it promulgated Rev. Proc. 2016-22, and when it denied Facebook access to Appeals. It requested *mandamus*-like relief.

44 Pub. L. No. 105-206, §§ 1001(a)(4), 3401, 112 Stat. 685, 689, 746 (1998) (establishing Appeals, and granting taxpayers a statutory right to a hearing before Appeals in connection with liens and levies, codified at IRC §§ 6320(b) (lien), 6330(b) (levy)). Section 3462 also directed the IRS to establish procedures for administrative appeals of IRS rejections of proposed installment agreements or offers-in-compromise under IRC §§ 6159 and 7122, respectively. In addition, other provisions assume that taxpayers have access to Appeals. *See, e.g.*, IRC §§ 6015(c)(4), 7430(c)(2), 6621(c)(2)(A).

45 *See, e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 478-489 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payments*) (recommending, in relevant part, that the right to appeal include the right "to be advised of and avail themselves of a prompt administrative appeal that provides an impartial review of *all* compliance actions (unless expressly barred by statute) and an explanation of the appeals decision"); National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (2013); National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (Most Serious Problem: *The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*).

46 IRS News Release IR-2014-72 (June 10, 2014).

47 Pub. L. No. 114-113, 129 Stat. 2242 (2015). For a discussion of the effect of the TBOR, see, *e.g.*, Alice Abreu & Richard Greenstein, *Embracing the TBOR*, 157 Tax Notes 1281 (Nov. 27, 2017).

48 IRC § 7803(a)(3), (a)(3)(E).

49 Notice 2015-72, 2015-44 I.R.B. 613.

50 Letter from Am. Bar Ass'n Section of Taxation to Comm'r, IRS, *Comments on Notice 2015-72* (Nov. 16, 2015), https://www.americanbar.org/groups/taxation/policy/policy_2015.html.

51 The IRS's request for comments may suggest it was seeking to increase the deference given to the final rule. However, the revenue procedure did not purport to establish "legislative" rules. If it had, the IRS would have been required to consider comments and provide a concise statement explaining the basis and purpose for a final rule under 5 U.S.C. § 553(c). The rule could have been challenged on the basis that the IRS did not address the comment and provide a reasoned explanation and that it was arbitrary and capricious under 5 U.S.C. § 706(2)(A). The Tax Court held in *Altera Corp. & Subs. v. Comm'r*, 145 T.C. 91 (2015) that a regulation was invalid because, in promulgating the regulation, the Treasury did not "adequately respond to commentators," *citing Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983) (requiring rules to be the product of reasoned decision-making). The Tax Court's decision was recently reversed, but the reversal was withdrawn. *See Altera Corp. & Subs. v. Comm'r*, No. 16-70496, 2018 WL 3542989 (9th Cir. July 24, 2018), *rev'g*, 145 T.C. 91 (2015), *withdrawn by*, 2018 WL 3734216 (9th Cir. Aug. 7, 2018).

The IRS moved to dismiss, countering that Facebook lacked standing and that its determination to deny Facebook access to Appeals was not reviewable under the APA because it was not a final agency action. The U.S. District Court for the Northern District of California granted the IRS's motion to dismiss. First, it reasoned that Facebook did not have an enforceable right to take its case to Appeals. The IRS's Statement of Procedural rules did not create enforceable rights and neither did the PATH Act. By its terms, the PATH Act required the Commissioner to train employees and ensure they act in accord with rights granted under "other provisions." Because of this training requirement, the TBOR was not a nullity. Even if the PATH Act had created enforceable rights, it was not clear that the "right to appeal in an independent forum" refers to a right to take a case to IRS Appeals, as opposed to the Tax Court.[52] Because deprivation of a nonexistent right does not constitute an injury, the court concluded that Facebook lacked standing.

The court also concluded that the IRS decision not to refer Facebook's case to Appeals was not reviewable under the APA. Unless another statute provides for review, only "final agency action for which there is no other adequate remedy in a court" is reviewable under the APA.[53] To be final, an action must (1) consummate the agency's decision-making process, and (2) establish rights and obligations or create binding legal consequences. The court concluded that neither the IRS's promulgation of Rev. Proc. 2016-22, nor its denial of Facebook's request to take its case to Appeals were final agency actions. The court reasoned that Rev. Proc. 2016-22 was not a final action because it did not create or determine any rights, obligations, or legal consequences.[54] Similarly, the IRS's decision not to refer the case to Appeals was not reviewable because Facebook's rights, obligations, and legal consequences will flow from judicial review, rather than from the IRS's decision not to refer its case to Appeals, according to the court.[55]

This case is significant because it suggests that the TBOR did not abrogate pre-existing limits on a taxpayer's right to an appeal. Perhaps more significantly, however, it suggests that when the IRS promulgates a revenue procedure that ignores stakeholder comments, ignores its own longstanding procedural rules, and then singles out one taxpayer for special treatment by withholding procedural protections afforded to other taxpayers without explanation, courts are helpless to review its actions.[56]

52 However, IRS Pub. 1, *Your Rights as a Taxpayer*, suggests the right encompasses both administrative and judicial appeal rights. It provides that "[T]axpayers are entitled to a fair and impartial administrative appeal of most IRS decisions… [and] Taxpayers generally have the right to take their cases to court." This language was heavily negotiated with the IRS by the National Taxpayer Advocate.

53 5 U.S.C. § 704. Facebook did not allege that the IRS's action was reviewable under another statute.

54 The court apparently did not consider the potential for the IRS to deny an administrative appeal to be a legal consequence. Nor did it discuss *Cohen v. United States*, 650 F.3d 717 (D.C. Cir. 2011), which held that a procedural notice that established excise tax refund procedures was reviewable under the APA as a final agency action.

55 A final decision by Appeals would seem to be a final agency action, but a decision to deny access to Appeals is not a final agency action, according to the court. As noted above, the IRS did not explain the basis for its decision to deny access to Appeals. However, the court did not discuss other cases where the IRS's determinations have been deemed arbitrary and capricious on the basis that they were inadequately explained. *See, e.g., Fisher v. Comm'r*, 45 F.3d 396, 397 (10th Cir. 1995), *non acq*. 1996-2 C.B. 2 (holding a supplemental notice of deficiency that did not provide reasons for declining to waive a penalty was invalid because "[i]t is an elementary principle of administrative law that an administrative agency must provide reasons for its decisions," *quoting Harberson v. NLRB*, 810 F.2d 977, 984 (10th Cir. 1987) and *citing SEC v. Chenery Corp.*, 318 U.S. 80, 94 (1943)).

56 This case illustrates how the IRS can issue and apply some procedural rules (*i.e.*, Rev. Proc. 2016-22, which provides a limited right to go to Appeals) in a way that burdens taxpayers and taxpayer rights, while at the same time ignoring other procedural rules (*e.g.*, 26 C.F.R. § 601.106(b)(3), which provides an unlimited right to go to Appeals) that would lessen this burden and be consistent with taxpayer rights.

In *United States v. Colliot*, the U.S. District Court for the Western District of Texas held that the IRS could not impose the maximum penalty provided by law for a willful failure to file a Report of Foreign Bank and Financial Accounts (FBAR) because it had not updated regulations which provided a lower maximum penalty.[57]

The IRS filed suit against Mr. Colliot to collect civil penalties assessed for the willful failure to report foreign accounts on a Report of Foreign Bank and Financial Accounts (FBAR) for years 2007-2010. The IRS's penalty assessments included $548,773 for four FBAR violations in 2007, and another $196,082 for four violations in 2008.

Mr. Colliot argued that the IRS's penalty assessments were arbitrary and capricious and an abuse of discretion because they exceeded the $100,000 limit set forth in a regulation that was validly issued in 1987 after public notice and comment and that was still in force.[58] The IRS countered that the maximum penalty provided by the 1987 regulation was superseded by a change to 31 U.S.C. § 5321(a)(5) in the American Jobs Creation Act (AJCA) of 2004.[59] The ACJA increased the maximum FBAR penalty from $100,000 to 50 percent of the amount in the unreported account (with no fixed cap).[60]

The court agreed with Mr. Colliot. When the statute sets a ceiling (but not a floor) for a penalty, it vests the Secretary with discretion to determine the penalty amount so long as it does not exceed the ceiling. By leaving the 1987 regulations in place, the Secretary used this discretion to limit the penalties the IRS would impose to amounts below the maximum provided by the statute (both before and after the AJCA). Thus, the 1987 regulation was consistent with the statute, as amended by the AJCA. Moreover, an agency can only repeal a regulation issued via notice-and-comment rulemaking by using the notice-and-comment rulemaking process.[61] Consequently, the IRS acted arbitrarily and capriciously when it failed to apply the regulation in assessing penalties against Mr. Colliot.[62]

This case is significant because it suggests that until the 1987 regulation is updated or repealed, it may limit the maximum penalty the IRS can impose for FBAR violations.[63] At the very least, this case

57 *United States v. Colliot*, 2018-1 U.S.T.C. (CCH) ¶50,259 (W.D. Tex. May 16, 2018).

58 *Amendments to Implementing Regulations Under the Bank Secrecy Act*, 52 Fed. Reg. 11436, 11445–46 (1987) (codified as 31. C.F.R. § 103.57(g)(2), and later re-codified as 31 C.F.R. § 1010.820(g)(2)) (authorizing Report of Foreign Bank and Financial Accounts (FBAR) penalties "not to exceed the greater of the amount (not to exceed $100,000) equal to the balance in the account at the time of the violation, or $25,000," an upper limit that reiterated what was then provided by 31 U.S.C. § 5321(a)(5)(C)).

59 American Jobs Creation Act of 2004 (AJCA), Pub. L. No. 108–357, § 821, 118 Stat. 1418, 1586 (2004) (codified at 31 U.S.C. § 5321(a)(5)(C)).

60 Before the American Jobs Creation Act (ACJA) of 2004 the maximum FBAR penalty under was the greater of (1) $25,000 or (2) 100 percent of the unreported account at the time of the violation, but not to exceed $100,000. 31 U.S.C. § 5321(a)(5)(C) (2003). The ACJA increased the maximum penalty to the greater of (1) $100,000, or (2) 50 percent of the amount in the account at the time of the violation (with no upper limit). 31 U.S.C. § 5321(a)(5)(C) (2018).

61 *See Perez v. Mortgage Bankers Ass'n*, 135 S. Ct. 1199, 1206 (2015) (requiring agencies to "use the same procedures when they amend or repeal a rule as they used to issue the rule in the first instance").

62 *See* 5 U.S.C. § 706(2) (requiring agency action to be "in accordance with law"). *See also Richardson v. Joslin*, 501 F.3d 415, 418 (5th Cir. 2007) ("[A]n agency must abide by its own regulations.") (*citing Accardi v. Shaughnessy*, 347 U.S. 260 (1954)). In lieu of dismissing the case with prejudice, on August 16, 2018 the court reformed (reduced) the amount of the FBAR penalty assessments to conform to the threshold set by 31 C.F.R. § 1010.820. *United States v. Colliot*, Order 1:16-cv-01281-SS (W.D. Tex. Aug. 16, 2018).

63 *Compare United States v. Urayb Wadhan et al.*, No. 17-CV-1287-MSK, 2018 WL 3454973 (D. Colo. July 18, 2018) (citing *Colliot* and limiting the penalty to $100,000), with *Norman v. United States*, No. 15-872T, 2018 U.S. Claims LEXIS 888 (Fed. Cl. July 31, 2018) (disagreeing with *Colliot* and allowing a penalty of more than $100,000 on the basis that the statute said the maximum penalty "shall be increased"). For additional discussion, see, *e.g.*, Robert Goulder, *Hurling F-Bombs at FBAR*, 91 Tax Notes Int'l 1083 (Sept. 3, 2018).

suggests the IRS faces litigating hazards if it continues to ignore the limits provided by the regulation. The government may also expect to receive claims for refund from taxpayers who have paid FBAR penalties of more than the maximums set forth in the 1987 regulation.

In *Estate of Stauffer v. IRS*, the United States District Court for the District of Massachusetts held that a taxpayer's "financial disability" suspended the period for filing a claim for refund because the IRS's refusal to consider a psychologist's diagnosis was unreasonable.[64]

Mr. Stauffer died at the age of 90. In 2013, his estate discovered that he had overpaid his taxes in 2006 when he was being treated by Dr. Schneider, Ed.D., a psychologist. The Estate sought a refund beyond the normal limitations period for filing refund claims under IRC § 6511(a).[65] It argued that the claim was timely because the period was suspended while Mr. Stauffer was "financially disabled." The Estate submitted a statement by Mr. Schneider as proof of Mr. Stauffer's disability.

With certain exceptions, IRC § 6511(h)(2) provides that a person is "financially disabled" when he or she "is unable to manage his [or her] financial affairs by reason of a medically determinable physical or mental impairment…." To establish a "financial disability," IRC § 6511(h)(2) requires the claimant to provide proof "in such form and manner as the Secretary may require." Pursuant to Rev. Proc. 99-21 the Secretary requires that the proof include a statement from a "physician," which it defines by reference to section "1861(r)(1) of the Social Security Act, 42 U.S.C. § 1395x(r)."[66] This definition excludes psychologists. Thus, the IRS denied the claim without determining whether Mr. Stauffer was financially disabled during the relevant period.

The Estate argued that the IRS unreasonably limited the proof it would consider. The IRS filed a motion to dismiss for lack of jurisdiction because the Estate had not filed a timely administrative claim with the IRS.[67] According to the court, IRC § 6511(h) authorized the IRS to establish a procedural rule as to the "form and manner" of offering proof of financial disability. Although 5 U.S.C. § 553 generally requires agencies to adopt rules only after providing the public with an opportunity for notice and comment, this requirement does not apply to "procedural" rules. The Estate did not argue that the IRS had exceeded its authority by using Rev. Proc. 99-21 to adopt a substantive rule without notice and comment. Thus, the court reviewed the "reasonableness" of the rule established by Rev. Proc. 99-21 according to the deferential "arbitrary and capricious" standard provided by 5 U.S.C. § 706(2)(A).[68]

Even under this deferential standard, however, the agency must provide a "reasoned explanation" for rejecting the "reasonably obvious alternatives" available to it.[69] The court said that it was not obvious

64 *Estate of Stauffer v. IRS*, 285 F. Supp. 3d 474 (D. Mass. 2017). A subsequent decision found the taxpayer was not financially disabled because a power of attorney was in effect. See *Stauffer v. IRS*, 2018 U.S. Dist. LEXIS 180954 (D. Mass. 2018).

65 IRC § 6511(a) (explaining the limitations period generally expires "within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later.").

66 Rev. Proc. 99-21, § 4, 1999-1 C.B. 960.

67 See IRC § 7422(a) ("no suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax … until a claim for refund or credit has been duly filed with the Secretary…").

68 In other words, the court essentially gave *Chevron* deference to Rev. Proc. 99-21, even though the government had announced it would no longer take the position that its revenue procedures were entitled to such deference. See Marie Sapirie, *DOJ Won't Argue for Chevron Deference for Revenue Rulings and Procedures, Official Says*, 131 Tax Notes 674 (2011). By contrast, a Magistrate Judge who had reviewed the case recommended giving mere *Skidmore* deference to Rev. Proc. 99-21 (*i.e.*, upholding it only to the extent it has the power to persuade) and concluded it was an unpersuasive interpretation of the law.

69 *Estate of Stauffer*, 285 F. Supp. 3d at 484.

why the IRS would refuse to consider the statement of a psychologist who contemporaneously diagnosed and treated the individual. Even in Social Security cases (*i.e.*, cases governed by the statute from which Rev. Proc. 99-21 borrowed its definition) a psychologist's opinion is entitled to great weight. The government offered no evidence that the IRS had any reason that was not arbitrary for adopting a definition of "physician" that excluded psychologists from the category of professionals qualified to support a claimant's financial disability. Thus, the court denied the government's motion to dismiss.[70]

This case is significant because it suggests that, notwithstanding Rev. Proc. 99-21, some courts may require the IRS to consider statements by psychologists when determining a person's financial disability. Accordingly, it could lead the IRS to address longstanding concerns expressed by the National Taxpayer Advocate and others that IRC § 6511(h), as implemented by Rev. Proc. 99-21, is too narrow to protect many taxpayers who are unable to make timely claims because of a physical or mental impairment.[71]

In *Borenstein v. Commissioner*, the Tax Court held it had no jurisdiction to review an overpayment claim by a non-filer who had obtained a filing extension because the IRS mailed the notice of deficiency at just the wrong time—after the second year following the original due date and before the third year following the extended due date.[72]

By April 15, 2013, Ms. Borenstein had paid more tax than she owed for 2012, but timely requested a six-month extension to file. Her prepayments were deemed to have been made on the due date of the return (*i.e.*, April 15, 2013, in the case of her prepayments for 2012).[73] Ms. Borenstein did not file a return by the extended due date of October 15, 2013. On June 19, 2015, the IRS sent her a notice of deficiency. She filed her delinquent 2012 return claiming a refund on August 29, 2015, and timely petitioned the Tax Court a few weeks later. The IRS argued the Tax Court lacked jurisdiction with respect to the overpayment.

The Tax Court has jurisdiction to determine if the taxpayer has made an overpayment with respect to a disputed year,[74] but only with respect to amounts paid during the applicable lookback period.[75] The lookback period ends on the date a taxpayer files an administrative claim for refund, unless the taxpayer

70 The court said that "a decision committed by statute to an agency's discretion may be subject to more limited review than the standard established in 5 U.S.C. § 706(2)(A)" and offered the IRS an opportunity to brief that issue. *Estate of Stauffer*, 285 F. Supp. 3d at 483, n. 2 (citations omitted). *See* 5 U.S.C. § 701(a)(2) ("This chapter applies, according to the provisions thereof, except to the extent that—…. (2) "agency action" is committed to agency discretion by law."). The court also discounted the IRS's argument that the psychologist's statement was submitted with the appeal and not with the initial claim. It cited various authorities for the proposition that imperfect claims, including those that lack a doctor's note, can be perfected later.

71 *See* National Taxpayer Advocate 2013 Annual Report to Congress 302-310 (Legislative Recommendation: *Broaden Relief from Timeframes for Filing a Claim for Refund for Taxpayers with Physical or Mental Impairments*). *See also* Bruce A. McGovern, *The New Provision for Tolling the Limitations Period for Seeking Tax Refund: Its History, Operation and Policy, and Suggestions for Reform*, 65 Mo. L. Rev. 797, 873 (2000); Keith Fogg & Rachel Zuraw, *Financial Disability for All*, 62 Cath. U. L. Rev. 965 (2013); American Bar Association, Section of Taxation, *Comments on Revenue Procedure* 99-21 (Feb. 1, 2018), https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/020118comments.authcheckdam.pdf. After this case was decided, the IRS requested comments on Rev. Proc. 99-21, but the request only concerned the burden associated with the paperwork requirements. *See* IRS, *Notice and request for Comments*, 82 Fed. Reg. 48,314 (Oct. 17, 2017).

72 *Borenstein v. Comm'r*, 149 T.C. No. 10 (2017), *appeal docketed*, No. 17-3900 (2d Cir. Dec. 4, 2017).

73 IRC § 6513(b).

74 IRC § 6512(b)(1).

75 IRC § 6512(b)(3).

did not file one, in which case, the period ends on the date the IRS mails the notice of deficiency.[76] The length of the lookback period also depends on when the taxpayer filed an administrative claim for refund.[77] For claims timely filed within the three-year period provided by IRC § 6511(a) (*i.e.*, within three years of filing the return), the lookback period is three years plus the period of any filing extension(s).[78] For other claims, the lookback period is two years.[79]

In *Lundy*, the Supreme Court held that the two-year lookback period applied to a non-filer because the taxpayer had not filed a return before the IRS mailed the notice of deficiency.[80] Like most non-filers, including the taxpayer in *Lundy*, Ms. Borenstein did not file a return before the IRS mailed the notice of deficiency (*i.e.*, June 19, 2015). Thus, the notice of deficiency would have been too late to trigger jurisdiction for amounts she was deemed to have paid on the due date (*i.e.*, April 15, 2013) under the two-year lookback period.

In response to *Lundy*, however, Congress added a final sentence to IRC § 6512(b)(3), which applies a three-year lookback period to certain non-filers.[81] The sentence states:

> … where the date of the mailing of the notice of deficiency is during the third year after the **due date (with extensions)** for filing the return of tax and no return was filed before such date, the applicable [lookback] period under subsections (a) and (b)(2) of section 6511 shall be 3 years. [Emphasis added.]

The IRS argued that this sentence did not give the Tax Court jurisdiction with respect to Ms. Borenstein's claim because October 15, 2013, was Ms. Borenstein's "due date (with extensions)" and the IRS did not mail her a notice of deficiency during the third year thereafter (*i.e.*, on or after October 15, 2015). Thus, Ms. Borenstein's notice of deficiency was mailed during the second year after the "due date (with extensions)," not the third.

Ms. Borenstein and *amici curiae* observed that the IRS's interpretation created an anomalous result—a donut hole in the Tax Court's overpayment jurisdiction as applied to non-filers with valid filing extensions.[82] The Tax Court would have had jurisdiction if the IRS had mailed the notice of deficiency on or between October 15, 2015, and April 15, 2016, but had no jurisdiction in this case because it mailed the notice during the donut hole period (*i.e.*, between April 15, 2015, and October 15, 2015). They argued that this anomalous result could be avoided.

The Tax Court agreed with the IRS, however, rejecting Ms. Borenstein's arguments as inconsistent with the plain language of the statute. It also declined to invoke the "anti absurdity" doctrine. While acknowledging that a plain-language interpretation of the law produced an odd result in certain circumstances, the court concluded that it did not render the amendment "absurd" as a whole.

76 Specifically, IRC § 6512(b)(3)(B) authorizes refunds or credits of amounts paid "within the period which would be applicable under section 6511(b)(2)… if on the date of the mailing of the notice of deficiency a claim had been filed (whether or not filed)…."

77 To be timely, IRC § 6511(a) generally requires a taxpayer to make an administrative claim for refund within two years of paying the tax or within three years of filing the return, whichever is later.

78 *See* IRC § 6511(b)(2)(A).

79 *See* IRC § 6511(b)(2)(B).

80 *Comm'r v. Lundy*, 516 U.S. 235 (1996).

81 Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1282(a) and (b), 111 Stat. 1037-38 (1997).

82 *Borenstein v. Comm'r*, 149 T.C. No. 10, at *5 (2017).

This case is significant because it suggests that Congress did not fully address the problem highlighted by *Lundy* in the case of non-filers who obtain filing extensions. Depending upon when the IRS issues a notice of deficiency, the Tax Court may not have jurisdiction to grant them refunds to which they would otherwise be entitled.[83]

In *Hulett v. Commissioner*, the Tax Court held that filing a return with the United States Virgin Islands (USVI) triggered the statute of limitations for U.S. Income Tax purposes, even if the taxpayers were not *bona fide* residents of the USVI, because the USVI forwarded parts of their return to the IRS.[84]

Taxpayers claiming residency in the USVI are required to file returns with and pay tax to the USVI Bureau of Internal Revenue (BIR), but before 2007 it was unclear what, if anything, they had to file with the IRS.[85] Their tax liability, which is determined under a "mirror code" system, is usually the same as it would be if they were residents of the United States. However, those who receive approval from the USVI Economic Development Commission may claim the Economic Development Program (EDP) credit under IRC § 934, which reduces the effective tax rate on certain income.[86]

Ms. Coffey (aka Ms. Hulett) worked in the USVI during 2003 and 2004 and filed joint returns with the BIR, rather than the IRS, because she claimed to be a *bona fide* resident of the USVI. The BIR sent photocopies of the first two pages of the Forms 1040 for the years at issue, along with their W-2s (both U.S. W-2s and VI W-2s) to the IRS pursuant to the Tax Implementation Agreement (TIA). The IRS processed the forms and created a tax transcript for those years, which showed a U.S. tax liability of zero.

The IRS began to audit the 2003 and 2004 returns in August 2005 and in May 2006, respectively, but did not issue a notice of deficiency until 2009. It contended that Ms. Coffey was not a *bona fide* resident of the USVI and was not entitled to the EDP credit. The Coffeys petitioned the Tax Court, arguing the three-year statute of limitations (SOL) on assessment provided by IRC § 6501(a) had expired. The IRS countered that the SOL was open because, for the year in question, it would only begin to run when the Coffeys filed a return with the IRS, not when they filed a return with the BIR. The Coffeys argued that even if they were not *bona fide* USVI residents and were supposed to file with the IRS, the BIR had forwarded their return information to the IRS, thereby triggering the SOL upon receipt by the IRS.

83 For a recommendation to fix this glitch, see Legislative Recommendation: Tax Court Jurisdiction: *Fix the Donut Hole in the Tax Court's Jurisdiction to Determine Overpayments by Taxpayers with Filing Extensions*, *supra*.

84 *Hulett v. Comm'r*, 150 T.C. No. 4 (2018), *motion for reconsideration filed* (Feb. 28, 2018). By way of background, the National Taxpayer Advocate has recommended legislation to provide a fixed statute of limitations to those claiming United States Virgin Islands (USVI) residency and filing with the Bureau of Internal Revenue (BIR). *See* National Taxpayer Advocate 2009 Annual Report to Congress 391-399 (Legislative Recommendation: *Provide a Fixed Statute of Limitations for U.S. Virgin Islands Taxpayers*). According to the Eleventh Circuit Court of Appeals: "We agree with the assessment made by the National Taxpayer Advocate in a 2009 report to Congress: [The IRS's statute-of-limitations position] sends the message that the IRS might arbitrarily eliminate the benefit of any SOL by singling out those who take advantage of legitimate tax incentives. Perceptions of arbitrary and unfair tax administration not only undermine the purpose of tax incentives designed to attract business to the USVI, but may also increase controversy and diminish the public's willingness to comply with the law, potentially reducing federal tax receipts." *Huff v. Comm'r*, 743 F.3d 790, 799 n.12 (11th Cir. 2014).

85 IRS Form 1040, *Instructions* (2004); IRS Pub. 570, *Tax Guide for Individuals with Income from U.S. Possessions* (2004). Although IRC § 7654(e) required the IRS to issue regulations under IRC § 932, the IRS did not provide specific guidance about the filing requirements until 2007. Notice 2007-19, 2007-1 C.B. 689 divided those claiming to be *bona fide* USVI residents into two categories: those who earned $75,000 or more and those who did not. Those earning more than $75,000 had to file with the BIR and send a zero return (*i.e.*, return reporting no gross income) to the IRS office in Pennsylvania, with a statement explaining the taxpayer's residency. Shortly thereafter, Notice 2007-31, 2007-1 C.B. 971, eliminated the income distinction and provided that all taxpayers claiming *bona fide* USVI residency should file just with the BIR, a position later adopted by regulation. Treas. Reg. § 1.932-1(c)(2)(ii). However, this was the IRS's position only for tax years ending on or after December 31, 2006.

86 *See* IRC § 934(b).

To qualify as a return under the *Beard* test, a submission must (1) contain sufficient data to calculate tax liability, (2) purport to be a return, (3) be an honest and reasonable attempt to satisfy the requirements of the tax law, and (4) be executed under penalties of perjury.[87] The IRS argued what it received from the BIR was not a return because it lacked an original signature and also because it did not contain sufficient data to allow the IRS to "verify" the liability, but the Tax Court was not convinced.[88]

The Tax Court observed that for purposes of getting interest on an overpayment, IRC § 6611(g) provides that "a return shall not be treated as filed until it is filed in processible form," which requires enough information for the IRS to verify the taxpayer's computations. Thus, IRC § 6611(g) implies that a filing that lacks sufficient information to be "processible" or verifiable can still be a return.[89] Moreover, returns need not be perfect.[90] Those that are fraudulent or missing schedules are still returns for purposes of the SOL.[91] The court explained that the IRS had received enough information to "compute" taxable income (*i.e.*, income, deductions, and credits) without creating special procedures, as evidenced by the tax transcripts it created, even if it had not received all of the information it needed to compute the correct taxable income or to verify it.

As to the other requirements, the Tax Court concluded that the Coffeys' filing purported to be a return because it was on the Form 1040. The court rejected the IRS's assertion that the Form 1040 was merely a territorial filing, as the failure to file it would have been prosecuted as a failure to file a Federal Income Tax Return. It also concluded that the filing was a reasonable attempt to satisfy the law, rejecting the IRS's assertion that the "reasonable attempt" prong of the test was subjective and that a return that reflected all zeros would have been more reasonable than what the IRS received. Further, the subjective intent of the taxpayer is not important because it would be impractical for the IRS to contemplate the taxpayer's state of mind when processing returns.[92]

Finally, the Tax Court found that the requirement to sign the returns under penalties of perjury was satisfied. Although the IRS objected that the signature was photocopied, the court reasoned that in certain circumstances the IRS accepts returns by fax.[93] Moreover, courts have concluded that even missing signatures can be overlooked in certain circumstances (*e.g.*, where one spouse neglects to sign

87 *Beard v. Comm'r*, 82 T.C. 766 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

88 The IRS did not argue that the returns did not start the SOL because they were not "filed" with the IRS.

89 Similarly, the court observed according to the Internal Revenue Manual (IRM), "a return will be valid even though it is missing Form W-2 or Schedule D, but it will not be processable because the calculations are not verifiable." IRM 25.6.1.6.16(2) (Oct. 1, 2010).

90 *Zellerbach Paper Co. v. Helvering*, 293 U.S. 172, 180 (1934).

91 *See Blount v. Comm'r*, 86 T.C. 383 (1986) (missing Form W-2); *McCaskill v. Comm'r*, 77 T.C. 689 (1981) (missing Schedule C); *Badaracco v. Comm'r*, 464 U.S. 386 (1984) (fraudulent returns).

92 Judge Marvel, writing for the dissent, argues that subjective intent of the taxpayer (or his or her representative) to file a return with the IRS is required to start the statute of limitations (SOL). Professor Camp observes that the majority of the Tax Court took a more functional approach that recognizes that the purpose of IRC § 6501(a) is to provide closure. *See* Bryan Camp, *Lesson From the Tax Court: Forms Follow Function in Return Filing*, TaxProf Blog (Feb. 5, 2018), http://taxprof.typepad.com/taxprof_blog/2018/02/lesson-from-the-tax-court-when-filing-a-return-is-a-matter-of-principle.html. He argues that the court's rational in *Coffey* is inconsistent with *Allen v. Comm'r*, 128 T.C. 37 (2007) where the Tax Court held that the extended SOL applicable to fraudulent returns applied to a taxpayer's return, even though a preparer, rather than the taxpayer, committed the fraud. For further discussion of *Allen*, see National Taxpayer Advocate 2007 Annual Report to Congress 562, 565 (*Significant Cases*).

93 *See, e.g.*, Rev. Rul. 68-500, 1968-2 C.B. 575 (fax signatures okay after authorization with original signature); Rev. Proc. 2005-39, 2005-2 C.B. 82 (permitting fax signatures on certain employment tax returns). *See also* CCA 200518079 (May 6, 2005) (concluding fax signatures are valid on a Form 872, *Consent to Extend the Time to Assess Tax*).

a joint return or where a subsidiary neglects to sign a consolidated return).[94] While the signature requirement helps to authenticate returns, in this case the BIR had already authenticated them.

This case is significant because it shows that the IRS continues to burden taxpayers and waste resources pursuing old cases without sufficient legal authority, even though it does not have clean hands and Congress has reiterated that taxpayers have the right to finality.[95] As the court explained:

> [t]he IRS failed to promulgate mandatory regulations under section 932, failed to tell taxpayers that they should file protective zero returns, and failed to send the Coffeys a notice of deficiency within three years of receiving the cover-over documents. And, only a few short years later, the IRS finally did promulgate regulations that adopt precisely the position that the Coffeys took about how to start the statute of limitations. Despite all this, the Commissioner tells us that the Coffeys lose—though one is left to wonder how the current regulation is valid if the Commissioner is correct that filing anything other than a zero return with the IRS would be inadequate under the Code.

Over a decade ago, stakeholders, including stakeholders in Congress, complained to the National Taxpayer Advocate about the IRS's position.[96] TAS warned the IRS that it would end up wasting resources by pursuing old cases based on unconvincing legal theories, as it apparently continues to do.[97] This case highlights the need for Congress to require the IRS to place more emphasis on taxpayer rights.[98] The case also helps to clarify what constitutes a return and when the IRS has received enough information to start the SOL.[99]

94 *See, e.g.*, *Estate of Campbell v. Comm'r*, 56 T.C. 1 (1971) (spouse); *Gen. Mfg. Corp. v. Comm'r*, 44 T.C. 513 (1965) (subsidiary).

95 IRC § 7803(a)(3)(F). *See Coffey v. Comm'r*, 150 T.C. No. 4, at *58 (2018).

96 *See, e.g.*, Letter from Ranking Member, House Ways and Means Committee, to National Taxpayer Advocate, *reprinted as*, *Rangel Requests Meeting With Olson on Tax Treatment of U.S.V.I. Residents*, 2007 TNT 64-15 (Sept. 19, 2006).

97 The IRS apparently prioritized revenue considerations. *See* Letter from IRS to Ranking Member, Senate Finance Committee, *reprinted as*, *USVI Proposal Would 'Significantly Affect Examinations,' IRS Says*, 2007 TNT 222-245 (Nov. 9, 2007).

98 *See* National Taxpayer Advocate Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 5-6 (Enact the Taxpayer Bill of Rights as a Freestanding Provision in the Internal Revenue Code*) (Dec. 2017). This case is one of many involving USVI SOL issues. *See, e.g.*, *Appleton v. Comm'r*, 140 T.C. 273 (2013).

99 Under the Tax Court's reasoning the SOL began to run when the IRS received two pages of the return from the BIR, however, a taxpayer would not know when the IRS received such information from the BIR. By contrast, Judge Thornton's concurring opinion suggests that the SOL started when the BIR received the returns because the return was a reasonable attempt to satisfy the requirement. More Judges joined this concurring opinion than the opinion of the court.