For Whom the Statute Tolls

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Wood and Shapiro examine whether an improperly filed Tax Court petition can toll the statute of limitations even if the IRS's original notice was invalid. Courts have found that such a petition tolls the statute as long as the IRS is unaware of the prior errors.

As Judge Richard Posner of the Seventh Circuit Court of Appeals has observed, "Statutes of limitation are not arbitrary obstacles to the vindication of just claims and therefore they should not be given a grudging application. They protect important social interests in certainty, accuracy, and repose."[1] Posner eloquently captured the importance these provisions occupy in our legal system. Yet in the famously complex tax law, the social interests Posner mentions may be obscured by technical questions regarding how the statute of limitations should be applied.

In tax cases, particularly partnership tax cases, these questions can be especially tricky. The IRS, courts, and tax practitioners must contend with numerous provisions detailing how and when assessment and collection statutes expire or become extended. Often, the same provision will point in two different directions.

For example, the IRS must issue a valid notice of intent to assess tax (such as a notice of deficiency) before the statute expires. Taxpayers then generally have 90 days to file a petition in Tax Court to contest the proposed assessment. If everything goes according to plan, the notice and the Tax Court petition will toll the statute while the court proceeding is resolved.

Of course, sometimes the plan goes haywire. Suppose the IRS fails to issue a valid notice of deficiency but the taxpayer nevertheless files a Tax Court petition? Alternatively, suppose the IRS issues a valid notice but the wrong party files a Tax Court petition?

Those problems occur more often than you might think. Each situation can present myriad choices about equity, fairness, notice, and statutory compliance, even in ostensibly simple tax disputes. In the world of partnership tax litigation, it is not hyperbole to say that the complexities can multiply exponentially.

What Suspends the Statute?

Section 6503(a)(1) provides for the tolling of various statutes of limitation on assessment and collection, as follows:

> (1) General rule. The running of the period of limitations provided in section 6501 or 6502 (or section 6229, but only with respect to a deficiency described in paragraph (2)(A) or (3) of section 6230(a)) on the making of assessments or the collection by levy or a proceeding in court, in respect of any deficiency as defined in section 6211 (relating to income, estate, gift, and certain excise taxes), shall (after the mailing of a notice under section 6212(a)) be suspended for the period during which the Secretary is prohibited from making the assessment or from collecting by levy or a proceeding in court (and in any event, if a

[1]*Cada v. Baxter Healthcare Corp.*, 920 F.2d 446, 452-453 (7th Cir. 1990).

> proceeding in respect of the deficiency is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter.[2]

There are several items to note in this language. First is that the suspension of the statute occurs "after the mailing of a notice under section 6212(a)."[3] A valid notice is therefore a prerequisite to the tolling of the statute.

Another feature of section 6503(a)(1) is that the statute is suspended during the period when the Treasury is prohibited from assessing tax or pursuing collection.[4] The tax code then adds a parenthetical (beginning with "and in any event"). This provides for extension of the limitations period when a "proceeding in respect of the deficiency is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final."[5]

The statutory language seems clear enough on its face. However, what if an invalid notice is mailed and subsequently a proceeding is nevertheless "placed on the docket" of the Tax Court? Is the statute suspended by the proceeding as it would be if the notice had been valid? Or has it expired because the notice was invalid?

Shockley v. Commissioner

The Tax Court and the Eleventh Circuit recently came to different conclusions regarding whether a petition filed by the wrong party can toll the statute in such a case. However, the confusion started with the IRS. The Service sent two notices of deficiency to a corporate taxpayer. One went to the correct address and one to an incorrect address.

The IRS mailed a *third* notice to the *correct* address of the corporation's former shareholders, the Shockleys. The Shockleys filed a protective petition in Tax Court that reads a little bit like a court filing contesting the court's jurisdiction.[6] In their petition, the Shockleys stated that the notice they received was improper. In the alternative, they disputed that any tax was owed by the company.

The Shockleys were presumably trying to protect the corporation from being automatically assessed with tax, which surely would have happened if neither they nor the corporation had filed a petition. It was a cautious and appropriate step for the Shockleys to take. Indeed, the IRS did not make an assessment once the petition was filed.

The Tax Court ruled that the IRS was now out of time to make an assessment because there was no timely notice of deficiency.[7] The court found that the protective petition filed by the Shockleys was proper but the notice sent to the Shockleys was invalid because the Shockleys were no longer associated with the corporation. Therefore, the Tax Court petition did not toll the statute.

Surprisingly, and much to the delight of the IRS, the Eleventh Circuit disagreed. The appeals court held that the Shockleys' Tax Court petition tolled the statute, although it was clear that the Shockleys had filed it with the opposite intention.[8] The court noted that at least one valid notice had been provided to the corporation.

Moreover, the court said that it found nothing in section 6503(a)(1) to require that *the taxpayer* had to be the one to authorize the petition for the statute to be suspended.[9] Instead, it followed the Tenth Circuit's reasoning in *Martin v. Commissioner*,[10] which held that a petition suspends the statute even if it is not authorized or ratified by the taxpayer. Both the Tenth Circuit in *Martin* and the Eleventh Circuit in *Shockley* seemed persuaded by the use of the passive voice in section 6503(a)(1).

Rather than referring to the taxpayer, the courts seemed to say that section 6503(a)(1) provides for the suspension of the statute of limitations as long as a petition "is placed on the docket" of the Tax Court. In other words, it should not matter who places the petition on the docket — the taxpayer, a shareholder, an affiliate, an enemy, or a Martian — as long as it is placed. In fairness, there is support for this construction in other cases as well.[11]

Apart from its focus on grammar and sentence construction, the Eleventh Circuit in *Shockley* was of the opinion that the Tax Court's decision put the IRS in a Catch-22. If the IRS made an assessment after the Tax Court petition had been filed, it might have violated the law.[12] On the other hand, if it did not make an assessment, the statute could expire if it

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[2]Section 6503(a)(1).

[3]*Id.*

[4]*Id.*

[5]*Id.*

[6]*Shockley v. Commissioner*, T.C. Memo. 2011-96.

[7]*Id.*

[8]*Shockley v. Commissioner*, 686 F.3d 1229 (11th Cir. 2012).

[9]*Id.* at 1238 (section "6503(a)(1)'s encompassing language . . . does not create fine distinctions based on the purported intent or authority of the filer of the proceeding").

[10]436 F.3d 1216, 1226 (10th Cir. 2006).

[11]*United States v. Shahadi*, 340 F.2d 56 (3d Cir. 1965) (rejecting the taxpayer's claim that jeopardy assessments were an exception to the tolling scheme and that the petition did not toll the statute) ("the statute . . . was intended to provide that the statute be suspended in any and all situations where action is taken by the taxpayer to have deficiencies redetermined by proceedings in the Tax Court"); *Am. Equitable Assurance Co. of N.Y. v. Helvering*, 68 F.2d 46 (2d Cir. 1933) (proceeding filed by nontaxpayer nevertheless tolled the statute); *Eversole v. Commissioner*, 46 T.C. 56, 64 (1966) (passive construction should be read to toll the statute as long as any proceeding is "placed on the docket," even if it's not brought by the correct taxpayer).

[12]*Shockley*, 686 F.3d at 1238.

was not tolled. In any case, the circuit court reasoned that the best outcome was to find that the statute was tolled as long as the Tax Court proceeding was ongoing.

Inevitably, taxpayers and their advisers will play Monday morning quarterback. What could or should the Shockleys have done? Perhaps they could have kept quiet and not filed a petition. Indeed, that is a primary reaction and the Shockleys must surely be saying this to themselves even today.

Yet if the Shockleys had not filed a petition, the IRS probably would have automatically assessed the corporation. Filing the petition, despite the dismal outcome for the Shockleys, was probably the right move. If the IRS had not provided any valid notice to the corporation, the circuit court would likely have ruled differently and the Shockleys' protective petition might well have succeeded.

Petition After Invalid Notice

Shockley suggests that as long as one valid notice was sent before the statute expired, a subsequent petition may toll the statute even if there is a defect in the petition. What if a valid notice had never been sent or had never been timely sent? In *Greve v. Commissioner*,[13] the Board of Tax Appeals found that a petition filed after an invalid notice did not suspend the statute.

The board noted that the error was the Service's own fault. Moreover, the IRS had multiple opportunities to correct its error. Instead, the commissioner chose to simply rely on what had been done previously. *Greve* has been followed by other courts that have found that defective notices and subsequent proceedings did not toll the statute.[14]

Underlying those cases is the principle that once the statute has expired, it cannot be restarted by the filing of a petition. For example, in *Welch v. Schweitzer*,[15] the taxpayer had extended the statute through December 31 and the IRS sent a notice on December 17 to an invalid address. Realizing its mistake, the Service sent a corrected notice in January after the statute had expired.

Similar to the Shockleys, the taxpayer in *Welch* filed a petition challenging the January notice. The Ninth Circuit held that the statute had expired and the IRS could not assess a tax despite the pendency of the Tax Court case. In effect, the taxpayer was not penalized for being careful.

Another instructive case is *Reddock v. Commissioner*,[16] in which the IRS sent a notice of deficiency to the wrong address on April 12, 1978, concerning a 1974 tax return.[17] The notice was returned to the Service as undeliverable. On April 26, 1978, the IRS reissued the notice to the correct address.

Being cautious, the taxpayer filed a Tax Court petition within 90 days of the original notice, on July 11, 1978. Despite the taxpayer's filing of a petition within 90 days of the original (invalid) notice and the pendency of the Tax Court proceeding, the Tax Court found that the IRS was out of time. Plainly, the statute had already expired before the corrected notice and before the Tax Court petition had been filed.[18]

The holdings in *Greve*, *Welch*, and *Reddock* show that valid and timely notice is needed for the statute to be extended. Even if a Tax Court petition is filed within the time period stated on the notice, the petition should not toll the statute if the notice is itself invalid. The same should be true if the notice is issued after the statute has already expired.

Implications for TEFRA

In partnership litigation, similar statute of limitations issues arise but the stakes can be much higher. The 1982 Tax Equity and Fiscal Responsibility Act created rules designed to simplify audits involving large partnerships.[19] TEFRA allows the IRS to adjust partnership items that can be resolved at the partnership level, rather than in multiple and separate proceedings with each partner.

Sadly, TEFRA is a tortured statute that adds complexity. As we recently noted, thorny timing mismatches remain between determinations at the partnership level and those at the partner level, despite TEFRA's goal of simplification.[20] And the U.S. Supreme Court is currently considering whether penalty determinations can even be made at the partnership level in *United States v. Woods*.[21]

TEFRA proceedings can involve hundreds of partners' tax liabilities totaling billions of dollars. Significantly, there is no ''partnership'' statute of

[13] 42 B.T.A. 142 (1940).

[14] *See, e.g., Midland Mortgage Co. v. United States*, 576 F. Supp. 101, 107 (W.D. Okla. 1983) (invalid notice does not toll statute; any proceeding based on that notice also fails to toll statute); *Atlas Oil & Ref. Corp. v. Commissioner*, 22 T.C. 552, 558 (1954) (proceeding on fiscal year taxes, over which Tax Court lacked jurisdiction, did not toll statute under section 277 of 1939 tax code).

[15] 106 F.2d 885, 888 (9th Cir. 1939).

[16] 72 T.C. 21 (1979).

[17] The statute would therefore expire on April 15, 1978.

[18] *See also Rogers v. Commissioner*, 57 T.C. 711, 713 (1972) (IRS sent certified mail to correct non-U.S. address one day before statute expiration but notice was invalid because postal service does not deliver certified mail to foreign addresses).

[19] Section 6221 et seq.

[20] Robert W. Wood and Dashiell C. Shapiro, ''Munro Stipulations: TEFRA Timing Mismatches Remain,'' *Tax Notes*, June 17, 2013, p. 1433.

[21] Dkt. No. 12-562.

limitations. Instead, each partner has its own statute, which may be determined under section 6501 or 6229.

However, the tax matters partner (TMP) for the partnership can extend the statute for all partners. The TMP is charged with receiving the final partnership administrative adjustment and filing a petition to challenge the Service's determination. Thus, statute of limitations issues can be difficult to discern and clarify. Litigation often focuses on issues such as the TMP's authority, the validity of the FPAA, and related matters.

In *O'Neill v. United States*,[22] the Ninth Circuit held that a ''defective'' TMP petition nevertheless operated to toll the statute under section 6229(d). The TMP had declared bankruptcy several months before the FPAA was issued. Consequently, its status as TMP had already terminated. Nevertheless, the Ninth Circuit held that the TMP's petition contesting the FPAA operated to toll the statute.

The court seemed driven by policy considerations, noting that if the statute was not extended, the IRS could be completely barred from assessing tax, as it must refrain from assessing tax until the case has been finally determined.[23]

Moreover, the language of section 6229 appeared to support the decision in *O'Neill* because it has a passive construction similar to that of section 6503(a)(1). Section 6229, which provides a separate statute for partnership cases, states that the period is tolled ''if a petition is filed under section 6226 with respect to such administrative adjustment.'' Like the phrase ''is placed on the docket,'' the language ''is filed'' suggests that any filing may extend the statute.

It is certainly worth questioning whether the Ninth Circuit's holding in *O'Neill* suggests that the *Greve* line of authority is no longer good law. In *O'Neill*, the notice was arguably invalid because it was sent to a party that was no longer the TMP, and if the notice was invalid, the Tax Court proceeding may have been untimely.

Nevertheless, the court held for the IRS. One possible view of *O'Neill* is that it is a rejection of *Greve*. Indeed, it shows that a petition filed after an invalid notice can — at least in some cases — toll the statute.

However, this view of *O'Neill* is neither necessary nor correct. The court's summary of the case contains a brief but revealing insight. The court notes that the TMP's bankruptcy (and therefore the invalidity of the notice) was ''unbeknownst to the Tax Court or counsel on either side.''[24] In other words, the IRS did not know (and presumably had no reason to know) that the TMP had declared bankruptcy and was no longer authorized to represent the partnership.

This point is of pivotal importance. The IRS did not know of the defect when it sent the notice or when the petition was filed. In *O'Neill*, the TMP did not inform the IRS that it had filed for bankruptcy, so the IRS had no reason to know that the TMP's status had terminated.

In contrast, in *Barbados #7 Ltd. v. Commissioner*,[25] the IRS had received notice of the TMP's bankruptcy before it obtained consents to extend the statute. This actual notice clearly mattered, as it should. In *Barbados #7 Ltd.*, the court held that the extensions of the statute that the IRS obtained from the bankrupt TMP were not valid. Therefore, the statute had plainly expired.

The key fact in *O'Neill* was the Service's lack of knowledge of the TMP's bankruptcy. This appears to have been what motivated the Ninth Circuit's decision, one that seems both logical and appropriate. The court's reasoning also seems entirely consistent with the ''last known address'' cases, in which courts have determined the validity of a notice of deficiency based on whether the IRS had knowledge or reason to know that the address it used was incorrect.[26] In both the TEFRA context and the income tax context, a notice or a consent to extend the statute is generally invalid if the IRS knows of a defect (in the TMP's authority or the taxpayer's address) and fails to cure that defect.

The facts of *O'Neill* stand in rather stark contrast to the facts in cases such as *Greve.* In *Greve*, the IRS

[22]44 F.3d 803 (9th Cir. 1995).
[23]*Id.* at 805-806.
[24]*Id.* at 805.
[25]92 T.C. 804, 810-812 (1989).
[26]*Sicari v. Commissioner*, 136 F.3d 925, 928 (2d Cir. 1998) (unreasonable for the IRS to rely on the address on the most recently filed return if the IRS has become aware prior to the mailing of the notice of deficiency that such address may be incorrect); *Powell v. Commissioner*, 958 F.2d 53, 56-57 (4th Cir. 1992) (notice was insufficient when change of address was on file with the IRS before the notice of deficiency was mailed); *Hubbard v. Commissioner*, 872 F.2d 183, 185-186 (6th Cir. 1989) (a misaddressed, undelivered, and unacknowledged letter does not constitute a notice of deficiency); *McPartlin v. Commissioner*, 653 F.2d 1185, 1188 (7th Cir. 1981) (IRS had received notice of petitioner's change of address and had communicated with petitioner at that address before the notice of deficiency was sent and petitioner had done nothing to conceal his address); *Kennedy v. United States*, 403 F. Supp. 619 (W.D. Mich. 1975) (IRS had correct address on file when notice of deficiency was mailed); *Estate of McKaig v. Commissioner*, 51 T.C. 331 (1968) (petitioner had filed a change of address with the post office before the notice of deficiency was sent and the post office had returned the notice to the IRS unclaimed with the correct address marked on the envelope).

had actual knowledge that its notice was defective and failed to correct it before the statute had expired. Viewed in that light, it is clear that *O'Neill* does not undermine the *Greve* line of authority in any respect. In fact, *O'Neill* merely suggests that an extension of the statute depends not only on the invalidity of the notice but also on the Service's knowledge of that invalidity.

Knowledge of Defect is Key

Professor Leandra Lederman has noted that in most cases a defective Tax Court petition does not toll the statute.[27] Lederman suggests that this majority rule is not correct under the language and legislative history of section 6503(a). She correctly points out that Congress was concerned about the Service's ability to assess tax.

Lederman also argues, however, that the better rule would be to toll the statute at least during the pendency of the petition in Tax Court, even if the Tax Court later declares the notice to be invalid. That way, she asserts, the IRS would have an opportunity to send the taxpayer a *valid* statutory notice.[28] Lederman's argument makes sense in cases such as *O'Neill*.

After all, it seems both efficient and fair to give the IRS more time when it does not know — and has no reason to know — that its notice is invalid. However, as the *Greve* line of cases demonstrates, sometimes the IRS will already have had an opportunity to send the taxpayer a valid notice. Despite that opportunity, if the IRS fails to do so, it should suffer the consequences. As Posner states, that is the nature and purpose of limitations periods.

In *Greve*, the IRS had multiple such opportunities. Yet at every turn it failed to correct its defective notice. As is appropriate, the courts appear to be influenced by the Service's knowledge and whether the IRS had reason to know. That theme is an undercurrent of the courts' decisions even if they do not always make the importance of that actual or attributed knowledge explicit in their opinions.

As Posner correctly points out, just claims are not the only interests worth protecting when it comes to questions surrounding the statute of limitations. Just and unjust claims alike are surely protected by the same statute. Moreover, taxpayers are entitled to know when a particular tax year is safe from audit. They deserve to know with certainty when the prospect of a potentially crippling tax liability has mercifully passed.

Indeed, statutes of limitation protect the important interests of "certainty, accuracy, and repose."[29] When the IRS itself makes errors that cause the statute to expire, and the IRS knowingly does so, there is no justification for subjecting taxpayers to the cost and uncertainty of litigation.

[27]Leandra Lederman, "'Civil'izing Tax Procedure: Applying General Federal Learning to Statutory Notices of Deficiency," 30 *U.C. Davis L. Rev*. 183, 209, n.131 (Fall 1996) (citing authorities).

[28]*Id.*

[29]*Cada*, 920 F.2d at 452-53.