The Statute of Limitations in Equitable Relief Cases

By Robert B. Nadler*

Introduction: The following article is excerpted from Chapter 1: Innocent Spouse Relief—Introduction and Important Developments of A Practitioner’s Guide to Innocent Spouse Relief, Second Edition, by Robert B. Nadler, which was published by the Tax Section this past spring. Footnotes have been omitted to comport with the style of the NewsQuarterly.

One of the great battles in the history of tax law involved the statute of limitations in equitable relief cases. The normal statute of limitations for the collection of a tax is ten years. The IRS simply did not want the ten-year statute to apply to equitable relief cases. Relying on its regulatory powers, the IRS imposed a two-year period of limitation for claims filed under section 6015(f). This was a skillful move because an agency’s regulations are entitled to substantial deference by the courts. On the other side, a two-year limitation period would seriously impair the welfare of thousands of innocent spouses who were not able to file a claim for relief within the two-year period. The shorter statute of limitations would leave many taxpayers with a debt that they were completely unable to pay. Taxpayers consistently filed law suits challenging whether the regulation was a permissible interpretation of the statute. The historic battle is of interest because an agency’s regulations are entitled to substantial deference by the courts. On the other side, a two-year limitation period would seriously impair the welfare of thousands of innocent spouses who were not able to file a claim for relief within the two-year period. The shorter statute of limitations would leave many taxpayers with a debt that they were completely unable to pay. Taxpayers consistently filed law suits challenging whether the regulation was a permissible interpretation of the statute. The historic battle is of interest because an agency’s regulations are entitled to substantial deference by the courts.

The Legislative Branch

When Congress enacted section 6015, it expressly provided a two-year limitation period for subsections (b) and (c), but Congress did not include a two-year period of limitations in equitable relief cases under subsection (f). This raised a question regarding what was the statute of limitations for filing a claim in equitable relief cases.

The Executive Branch

When section 6015(f) was passed without a limitation period, the IRS faced a dilemma. The IRS had to reconcile two competing interests: (1) the legislative purpose of section 6015 to expand innocent spouse relief; and (2) the agency’s role as the nation’s tax collector with a statutory right to collect taxes due within the ten-year collection statute. To address these competing interests, the IRS used its regulatory power to create a two-year limitation period for filing a claim for equitable relief. The regulation effectively accomplished two things. First, the regulation protected the IRS’s right to pursue collection for the entire ten-year collection statute. Second, no matter how much economic hardship existed, no matter how sick the taxpayer was, no matter how inequitable the facts and circumstances were, after two years had passed from the first collection activity, the regulation barred taxpayers from filing claims for equitable relief.

So taxpayers challenged the validity of the regulation in numerous court cases. The IRS began the battle from a position of strength because legislative regulations are entitled to substantial deference.

The Judicial Branch

The issue was first presented in Lantz v. Commissioner, 132 T.C. 131, rev’d, 607 F.3d 479 (7th Cir. 2010), where the Tax Court held that the regulation was invalid based on the court’s view that by omitting a limitation period in subsection (f), Congress manifested an intent not to impose a deadline on equitable relief claims.

The IRS appealed Lantz to the Seventh Circuit Court of Appeals and argued that where Congress did not include a period of limitations in a statute, the agency could “borrow” a limitations period from another statute. The Seventh Circuit agreed with the IRS and reversed the Tax Court, ruling that the regulation was valid. The Court of Appeals primarily relied on a line of cases that allowed an agency to borrow a statute of limitations where Congress had not provided one in the statute. The Court of Appeals did not address the taxpayer’s argument based upon the Russello case in which the Supreme Court held that where Congress includes a statute of limitations in one part of a statute and omits a statute of limitations in another part of the statute, the failure to include a limitations period is presumed to be intentional.

The Third Circuit Court of Appeals was the second circuit to consider the validity of the statute. In Mannella v. Commissioner, 631 F.3d, 115 (3d Cir. 2011), rev’g 132 T.C. 196 (2009), the Court of Appeals applied the Chevron test to the language in section 6015(f). Under the first Chevron test, which requires a court to determine whether Congress has directly spoken to the question at issue, the court found that the failure to include the statute of limitations left an ambiguity that the agency could fill. Then the court applied Chevron’s second test and held that the regulation was reasonable. Importantly, one judge wrote a vigorous dissent, spending considerable time refuting the reasoning in the Lantz opinion.

The IRS won the third battle in the Fourth Circuit Court of Appeals in Jones v. Commissioner, 642 F.3d 459 (4th Cir. 2011). The Fourth Circuit joined the two other Circuit Courts of Appeals holding that the regulation was valid.
With three Courts of Appeals upholding the regulation as valid, most practitioners believed that the likelihood of achieving a win in one of the other circuits was remote. And without a split in the circuits, there would be no opportunity for Supreme Court review.

Congress Weighs In

When defeat appeared almost certain, an unexpected development occurred. On April 18, 2011, 49 members of Congress sent a letter to IRS Commissioner Shulman. In the letter, the members pointed out that of the 50,000 taxpayers annually filing claims for innocent spouse relief, 2,000 were time barred by the regulation’s two-year limitation period. The members pointed out that in enacting section 6015(f) Congress did not include a statute of limitations. Then the letter noted that the IRS “improperly ‘borrowed’ the two-year statute of limitations in 6015(b) and 6015(c)” and applied it to section 6015(f). The letter further indicated that the lack of a statute of limitations was intentional, pointing to Russello v. United States, a Supreme Court case which held that when language included in one part of a statute is omitted in another part of the statute, it is presumed that Congress acted intentionally. Finally, the letter stressed that a court may weigh all the facts and circumstances in considering appropriate relief. But by limiting the statute to two years, the facts and circumstances in a given case would not be considered after the two-year period had expired, leaving innocent spouses without a defense to collection action for the years three through ten in the collection statute. At the end of the letter, the members asked the Commissioner to reconsider the two-year statute of limitations.

On April 18, 2011, Senators Max Baucus, Sherrod Brown, and Tom Harkin sent a letter to the Commissioner requesting him to conduct a thorough review of the regulation. The letter underscored that in many cases the two-year limitation period denied equitable relief to the very taxpayers Congress intended to help. The letter concluded that the two-year rule ran counter to the spirit of equitable relief.

Two letters from Congress changed everything and the opportunity for a just result had now shifted in favor of innocent spouses.

The IRS Responds

Facing almost certain legislative action, the IRS undertook a comprehensive review of the regulation. On July 25, 2011, the IRS issued new guidance that it would no longer use the two-year limitation in equitable relief cases. IRS Notice 2011-70, 2011-32 I.R.B. 135. In the future, the IRS would allow claims for the entire ten-year period in the collection statute. Importantly, all cases pending on the effective date, July 25, 2011, would be subject to the longer statute. And all claims that had been denied for untimeliness and were not litigated could reapply for relief under section 6015(f).

Conclusion

The regulation creating the two-year limitation period affected thousands of taxpayers. Although the IRS position was not based upon a compelling policy, the regulation had great strength under a Chevron analysis and was upheld in three Circuit Courts of Appeals. When the IRS victory seemed almost certain, members of Congress wrote letters to the Commissioner recommending that the IRS had erred in adopting a two-year limitation period and asked him to review the regulation. Faced with few or no choices, the IRS accepted defeat and abandoned the two-year period in favor of the ten-year collection period. The long battle over the statute of limitations in equitable relief cases was finally over and it was a great victory for taxpayer rights.

A Practitioner’s Guide to Innocent Spouse Relief, Second Edition

Several major developments have occurred since the initial publication of A Practitioner’s Guide to Innocent Spouse Relief. Notable developments included the IRS abandoning its two-year statute of limitations position on taxpayer equitable relief claims. The IRS also published Rev. Proc. 2013-34, which provided new guidance in equitable relief cases.

In this newly revised edition, the author explains:

- How to recover your client’s tax refund when the IRS grants relief under section 6015(c).
- Even though the IRS has eliminated abuse as an independent factor in Rev. Proc. 2013-34, why abuse is still a major element of an equitable relief claim.
- What to do when the IRS sends a collection notice for a joint tax assessment, and your client says “I did not file” a joint return.
- What steps to take to protect the client’s innocent spouse claim while the client is going through a divorce.
- Why it may be necessary to file a protective refund claim in some innocent spouse cases.
- Why the first meeting with the client can dictate the success or failure of recovering your client’s tax payments.

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