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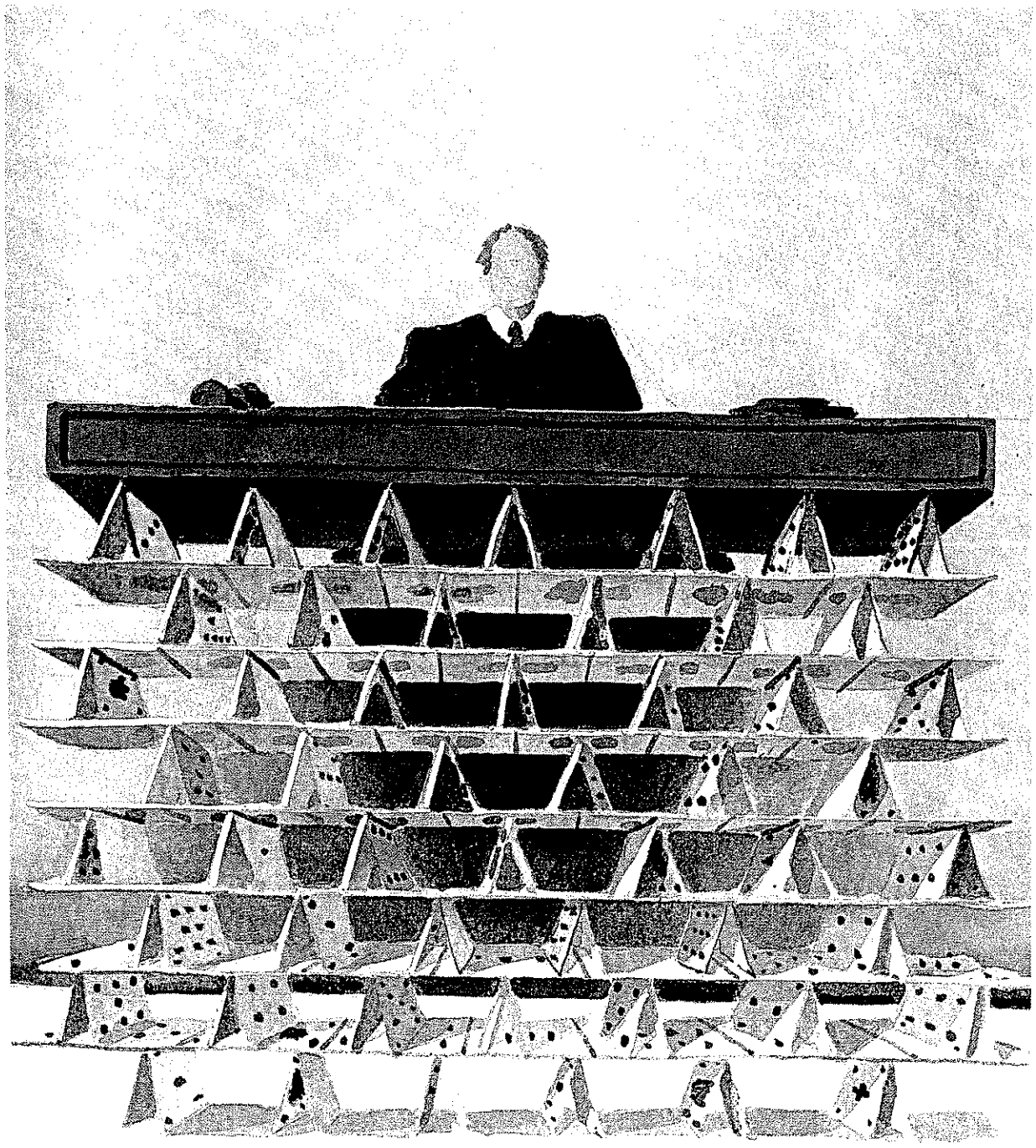

JUDICIAL STAFF AND ETHICAL CONDUCT

Fighting the Statute of Limitations — Is There Hope?

Clearly, the area of abatement of interest needs to be addressed by the same Congress which granted the Service sole authority for review

by Michael S. Singer and George D. Karibjanian

Your client asks you to look into a matter that has seemingly dragged on for years with the Internal Revenue Service (the Service). The tax year or years in question are several years removed and the Service has yet to act. You wonder how long the Service can take to determine whether a deficiency exists.

The Internal Revenue Code (the Code) provides that the Service generally has three years from the date that a return was filed (regardless of whether the return was timely filed) to determine a deficiency against a taxpayer.[1] Even if a taxpayer files early (before April 15 for individuals), the statute of limitations (the statute) remains open for three years from the due date of the return.[2] Under ordinary circumstances, the earliest the statute would expire for individuals is three years from April 15 (March 15 for corporations) if the return were timely filed. However, the statute may be extended by mutual "agreement" between the taxpayer and the Service for either a "limited" or an "unlimited" period of time.[3]

This article will examine the ramifications of the statute in very practical terms. Because many attorneys do not understand the ground rules, they struggle to determine if any valid angle of attack exists for their clients. This article will also examine the process of advising a client who is approached by the Service with a request to "extend" the statute.

A common impression is that the Service will take its time in assessing a deficiency. An examination of a tax item will often occur during the year in which the statute will expire. If the Service does not assess a deficiency within the three-year period, absent a demonstration of fraud or a substantial understatement of tax, the statute will expire and the Service will be foreclosed from assessing a deficiency for that period.[4]

Often the Service will ask your client to extend the statute. This may cause your client great stress, as an unknown, slow process appears to be progressing even slower. Additionally, if a deficiency is assessed against your client, interest and penalties are charged not from the date of assessment but from the due date of the return.[5]

When faced with a situation where a deficiency has not been assessed for a given tax year and a lengthy span of time has passed, the practitioner must determine whether any technical avenues exist for protest. If more than three years have passed since the due date of a timely filed return and an audit is ongoing, it is more than likely that your client has signed a consent to extend the statute of limitations. The two forms for extending the statute are Form 872-A and Form 872. Although similar in number, these forms differ greatly in context and operation. Form 872-A is an unlimited extension of time for the Service to assess a tax deficiency against a taxpayer as to the given tax year, tax issue, or both. The only way a taxpayer can close the statute upon executing a Form 872-A is to file a Form 872-T, which terminates the unlimited extension. Many taxpayers do not file a Form 872-T, however, fearing that the Service will "retaliate" and assume the most aggressive position possible against the taxpayer.

While the Form 872 is also a consent to extend the statute, it only extends the statute for an agreed period of time. An agreed time might typically be six months or one year. If the Service has not assessed the taxpayer before the expiration of the extension, the Service must obtain an additional extension from the taxpayer prior to such expiration or the statute will lapse.

Two types of client situations will be examined. The first client asks you if he should extend the statute and the second client has already extended the statute.

Many taxpayers and attorneys often assume that if the taxpayer does not extend the statute, the IRS will arbitrarily assess a deficiency against the taxpayer. Technically, if the taxpayer does not execute the extension, the Service must use its best efforts to determine a deficiency which the taxpayer can later appeal. Subject to the discussion below, it is probably in the taxpayer's best interest to execute some

form of extension in order for the tax to be properly determined. However, the indefinite extension from Form 872-A is exceptionally dangerous because it is openended. This extension will often cause your client great worry and may inhibit your client in conducting present transactions until the tax matter is resolved. The taxpayer should instead execute the limited extension under Form 872. The burden is then shifted to the Service to move faster and to ask for a further extension if more time is needed.

The major disadvantage to providing the Service with more time is that while the Service is "investigating," the interest and penalties continue to mount. In many situations, given the interest rate that the Service charges for the "time-use" of the funds, the interest itself can be three to four times the amount of the tax. Furthermore, this rate is much higher than the rate that the taxpayer can earn on the disputed funds.[6]

The second scenario is where your client has already signed the unlimited extension. Your client, especially in the situation where it appears that the Service has dragged its feet, might agree that he or she owes some tax but that the interest and penalties have reached such biblical proportions that the total liability is "obscene."

The client may say, "I'll pay 'x' amount. You just go and get some of this interest abated. The Service has taken a ridiculous amount of time, don't you agree?" You probably will agree. But is there anything you can do?

Prior to 1986, no procedure existed for internal review by the Service for abatement of interest claims. Furthermore, the Tax Court and the federal district courts had consistently held that neither court had jurisdiction to rule on an abatement of interest claim.[7] In response to this situation, Congress, in 1986, added §6404(e) to the Code which basically states that in the case of any deficiency attributable in whole or part to any error or delay by an officer or employee of the Service in performing a "ministerial act," interest may be abated for the period in which the failure to perform the ministerial act occurred. However, the Service may review such request (made through Form 843—Request for Abatement of Interest) only if no significant aspect of the delay can be attributed to the taxpayer.[8] The legislative history to §6404(e) is brief.[9] Apparently, the purpose in enacting §6404(e) was to grant sole authority to the Service to ascertain whether a taxpayer's case had been delayed due to the administrative failures of the Service and to give the Service authority to remedy such cases.[10]

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Congress instructed the Treasury Department to promulgate regulations establishing procedures for administrative review of an interest abatement case. The Service, under the Treasury Department's instruction, responded by publishing Revenue Procedures 87-42 and 87-43 which basically echo the sentiments of §6404(e) and state that the Service has the sole authority to review a claim for interest abatement attributable to deficiencies for matters arising after December 31, 1978, even after interest has been imposed.[11] A taxpayer who feels that his or her case has been delayed due to bureaucratic inertia may now petition for a redetermination of interest by filing a request for interest abatement with the Service.

The passage of §6404(e) was envisioned by Congress to have two purposes. First, Congress wished to squarely grant authority to the Service to determine whether interest abatement would be proper in a given situation while at the same time preventing such question from being reviewed by either the Tax Court or the federal district courts. Second, Congress envisioned an administrative process whereby taxpayers would get an objective review of the timeliness of the handling of their case.[12]

As previously stated, prior to §6404(e), the Tax Court in the majority of its decisions in these cases held that it did not have the authority to abate interest assessed upon a deficiency due from a taxpayer. The Tax Court reasoned that the taxpayer had the "time-use" of the money that he or she owed the Service and had not yet paid. In these decisions, the Tax Court stated that the appropriate forum for review of interest abatement claims was the federal district courts.[13] Thus, according to the Tax Court, in order to enter the appropriate forum, the taxpayer would be forced to pay the amount of the deficiency (including any applicable interest and penalties) and bring an action for a refund.[14]

While the Tax Court directed the taxpayer to the federal district courts for an answer, several district courts have held that they also do not have the authority to review interest abatement claims. This line of cases states that the Service had the right to charge the taxpayer interest arising from a deficiency owed by the taxpayer, because the taxpayer had the time-use of the money.[15] Accordingly, prior to the enactment of §6404(e), a taxpayer whose only grievance was that the Service dragged its feet, had very little chance of satisfaction from the courts for lack of jurisdiction and had virtually no chance of an internal review by the Service as it administratively had no power to abate interest.

After the publication of Revenue Procedure 87-43, the Service designated "interest abatement coordinators" for its offices. The purpose of these coordinators was to review all interest abatement claims made under §6404(e) and Revenue Procedures 87-42 and 87-43.[16]

In our experience with the Service, we found the interest abatement process to be far from satisfactory. In our case, the Service took nearly 13 years to finally issue a notice of deficiency because the Detroit office failed to receive communication from the New York office. Furthermore, various Service agents could not compile multiple partnership pass-throughs in a tax shelter limited partnership where virtually all other partners in the tax shelter had reached a settlement nearly 10 years prior. The Detroit office determined that there was no failure to perform "ministerial acts" on the part

of the Service and therefore denied any interest abatement. In the same matter, the Fort Lauderdale office determined such failure existed, but only for a period of several months.[17]

This process certainly seems unfair and distorted. Furthermore, if abatement is denied by the Service, there does not appear to be any further avenue of protest or appeal for the taxpayer. After the passage of §6404(e), both the Tax Court and several federal district courts have stated that since Congress sought to squarely place the authority to review such claims with the Service by enacting §6404(e), neither court has any power to review matters pertaining to abatement of interest.[18] The only exception to this rule is if the review by the Service and subsequent denial of abatement was made discriminatorily (a denial based on race, gender, etc.).[19] No case exists where a court has found such discriminatory review to have occurred.

Accordingly, if your client has participated in a post-1978 venture and believes he or she is entitled to an abatement of interest, the only avenue of recourse is to file a petition with the Service for abatement of interest for failure to perform "ministerial acts." The Service will then decide whether it acted improperly and rule whether an abatement of interest is proper.[20]

What if your client participated in a pre-1979 venture? The answer might be that this client is even worse off than those clients who participated in post-1978 ventures, as the client does not have the right to an interest abatement review by the Service under §6404(e) because the Service has not been granted the power to review interest abatement claims for such years.[21]

While the judicial system offers little hope to post-1978 taxpayers, perhaps the court system is the proper avenue for pre-1979 taxpayers. However, since the enactment of §6404(e) no court has squarely confronted the issue of abatement of interest for the pre-1979 taxpayer.

An argument can be made that since Congress granted authority to the Service to review post-1978 claims, Congress intended to leave those interest abatement matters which were significantly older to the wisdom of the courts since such matters were probably far more egregious. The Service might respond to this argument by stating that in enacting §6404(e), Congress chose to acknowledge and grant rights to a certain class of taxpayers (post-1978 taxpayers) and to purposefully exclude any other cases from review.

If the courts decide that they do not have jurisdiction to review abatement of interest claims for pre-1979 years, those taxpayers would be completely without remedy. If a court were to hold that it has jurisdiction, it will have to overrule case law prior to the enactment of §6404(e) or simply add judicial gloss to the arbitrary date assignment of §6404(e) and establish a more uniform system of interest abatement.

Absent any changes in the current law, are there any other arguments available in these situations? One argument is that even though the Form 872-A extension is of an "unlimited" nature, surely the extension must expire after a reasonable period of time.[22] Unfortunately, a very unified line of cases has held that an unlimited extension is valid until it is terminated by the taxpayer and furthermore does not expire at the end of any "reasonable" length of time.[23]

Another avenue which might be examined is the actual procurement of the extension by the Service. One of the authors recently argued that the Service misrepresented the contents of the unlimited extension when presenting the extension to the taxpayers thereby invalidating said extension.[24] The taxpayers claimed that when the Service obtained the extension, they were told the extension was only for two years. The taxpayers, acting without counsel, thought they had signed the equivalent of Form 872. In arguing the contents of the extension were misrepresented, the taxpayers cited *Whitman v. Commissioner*, 50 T.C.M. 1322 (1985), in which the Tax Court stated that as to an extension, the Service has the burden to prove that the period of limitations had been extended by way of producing a facially valid extension form. Once the commissioner has made such production, "in order for the petitioners to invalidate the Form 872 [the extension], they must prove that they executed it while incompetent, subject to fraud or

duress, or that the content was misrepresented by respondent."[25]

The argument of "duress" referenced in *Whitman* was successful in *Leslie D. Robertson v. Commissioner*, 32 T.C.M. 955 (1973). The Tax Court defined "duress" as follows:

> [I]f an act of one party deprives another of his freedom of will to do or not to do a specific act, the party so coerced becomes subject to the will of the other, there is duress and in such a situation no act of the coerced person is voluntary and contracts made in such circumstances are void because there has been no voluntary meetings of the minds of the parties thereto . . . (emphasis in original).[26]

The court held that the choice offered by the agent to execute the extension or subject the taxpayer's property to collection of an unknown tax amounted to duress. Furthermore, the actions amounting to duress did not have to be forceful, but merely such that the coerced party would adopt the will of the party exerting such force or will and thereby negating a meeting of the minds.[27] Numerous cases exist where the Tax Court has held that if an extension to a statute of limitations is signed under duress, the extension is invalidated.[28]

The abatement of interest process is a stacked deck against the taxpayer. Clearly, the area of abatement of interest needs to be addressed by the same Congress which granted the Service sole authority for review. The courts, for tax years beginning January 1, 1979, essentially have no power to review the findings of the Service, which itself acts as judge and jury. For taxpayers who have claims arising prior to 1979, there may be no hope. It is certainly the hope of these authors that the courts will choose to rule on abatement of interest for pre-1979 matters. We also can only hope that the courts or Congress will also see fit to institute some process to replace the existing review process which is clearly far from objective. ❐

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[1] 26 U.S.C. §6501(a) (1989).

[2] 26 U.S.C. §6501(b)(1) (1989).

[3] 26 U.S.C. §6501(c)(4) (1989).

[4] 26 U.S.C. §6501 (1989).

[5] 26 U.S.C. §6601 and §6621 (1989).

[6] For example, for the quarter beginning July 1992, the interest rate would be eight percent for underpayments attributable to deficiencies (Internal Revenue News Release 92-66, June 1, 1992). A random sampling of Palm Beach area banks indicated that certificates of deposit in June 1992 averaged a four percent return, indicating a four percent difference in favor of the Service.

[7] *See* Betz v. Commissioner, 90 T.C. 816 (1988); Cibelli v. United States, 84-1 USTC ¶9318 (D. Conn. 1984); LTV v. Commissioner, 64 T.C. 589 (1975).

[8] 26 U.S.C. §6404(e)(1) (1989).

[9] H.R. REP. No. 99-426, 1986-3 C.B. Vol. 2; S. REP. No. 99-313, 1986-3 C.B. Vol. 3; CONFERENCE REPORT No. 99-841, 1986-3 C.B. Vol. 4.

[10] *Id.*

[11] Rev. Proc. 87-42, 1987-2 C.B. 589; Rev. Proc. 87-43, 1987-2 C.B. 590.

[12] Note 9, *supra.*

[13] *See Betz*; *LTV*; and Benson v. Commissioner, 51 T.C.M. (CCH) 136 (1985).

[14] This is contrasted with filing a petition in the Tax Court which requires no payment of tax, and only a Tax Court filing fee.

[15] *See Cibelli*; Bowman v. United States, 87-2 USTC ¶9544 (6th Cir. 1987); United States v. Means, 80-1 USTC ¶9411 (6th Cir. 1980).

[16] Internally, the Service designates these "coordinators" to handle interest abatement matters.

[17] Schacher v. Commissioner, United States Tax Court Case No. 24560-90-ZZ-CROSS-PTN.

[18] *See* Estate of Camara v. Commissioner, 91 T.C. 957 (1988); Horton Homes, Inc. v. U.S., 91-2 USTC ¶50,370 (11th Cir. 1991), *aff'g* 90-1 USTC ¶50,058 (M.D. Ga. 1990); Brahms v. U.S., 89-2 USTC ¶9601 (Cl. Ct. 1989).

[19] *See Horton Homes*; *Brahms*; and Selman v. United States, 90-2 USTC ¶50,441 (W.D. Okla. 1990).

[20] In a sense the Service acts as both judge and jury.

[21] A review of the legislative history to the Tax Reform Act of 1986, as well as the committee reports, and including the House of Representatives and Senate floor debates do not provide background as to why interest abatement under §6404(e) applies solely to post-1978 events. Thus, we are left with the conclusion that this is an arbitrary date. In *Schacher*, one of the authors attempted to abate interest for the years 1976 and 1978, and was denied based on lack of authority for the Service to review such years. The Service did state, off the record, that if they had the power, a "substantial" abatement would have been proper. Every administrative appellate process was conducted with the same result—"we'd love to help you, but since your activity was before 1979 we don't have the power to do so."

[22] McManus v. Commissioner, 65 T.C. 197 (1975).

[23] *See Camara*; and Stenclik v. Commissioner, 56 T.C.M. (CCH) 1059 (1989).

[24] Schacher v. Commissioner, United States Tax Court Case No. 24560-90-ZZ-CROSS-PTN.

[25] Whitman v. Commissioner, 50 T.C.M. 1322, 1325 (1989). This matter in *Schacher* was ultimately settled prior to judicial determination of the claim.

[26] Robertson v. Commissioner, 32 T.C.M. (CCH) 955, 959 (1973), *quoting* Alfred J. Diescher, 18 B.T.A. 353, 358 (1929).

[27] Robertson v. Commissioner, 32 T.C.M. (CCH) 955 (1973).

[28] *See* Jarvis v. Commissioner, 40 T.C.M. (CCH) 1225 (1980); Rault v. Commissioner, 43 T.C.M. (CCH) 1446 (1982); Cindrich v. Commissioner, 48 T.C.M. (CCH) 252 (1984); Harrington v. Commissioner, 48 T.C.M. (CCH) 837 (1984); Houlberg v. Commissioner, 50 T.C.M. (CCH) 1125 (1985); Rutter v. Commissioner, 52 T.C.M. (CCH) 326 (1986); Ballard v. Commissioner, 54 T.C.M. (CCH) 580 (1987); and American Educare, Ltd. v. Commissioner, 59 T.C.M. (CCH) 212 (1990), all holding that if the petitioner could prove that the extension was signed under duress, that such extension would be invalid. These cases were all analyzed on a factual basis and most held against the petitioner. (*See also* Schwotzer v. Commissioner, 51 T.C.M. (CCH) 902 (1986) in which a Form 872-A was unintentionally executed by the taxpayers.)