

High-Profile Case Highlights Government's Common Law Right to Pursue Tax Deficiencies in Court

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A federal district court ruled in a high-profile case that the Justice Department may rely on common law rather than the statutory notice of tax deficiency procedure in the Internal Revenue Code to assert a federal income tax deficiency.

In *United States v. Liberty Global, Inc.*, No. 1:22-cv-02622-RBJ (D. Colo. June 1, 2023), the District Court of Colorado held that “It is generally accepted that the Government may proceed under two methods in order to satisfy a taxpayer’s obligation—either through summary collection procedures, such as a tax lien or tax levy or through its common-law right to sue for outstanding debt.”

The taxpayer in *Liberty Global* engaged in an international transaction and sought to avail itself of a mismatch in effective dates of provisions in the Tax Cuts and Jobs Act of 2017 (“TCJA”), a mismatch that the government argues was unintended.[1] The taxpayer timely filed its 2018 income tax return, not availing itself fully of the opportunity to reduce its income because of the mismatch. As a result, the taxpayer included income that the mismatch would otherwise allow to be deducted. Two months later, the taxpayer filed an amended return claiming a refund for the “mismatched” income that it did not deduct in its original return. The taxpayer thus included in its original return a potential for a refund claim and then claimed a refund in the amended return, all with an apparent purpose of using the refund claim procedure in the Internal Revenue Code to file an action in federal district court and end the IRS’s administrative examination of the 2018 return.[2]

The IRS began its examination of the taxpayer’s 2018 returns. When the IRS did not act on the amended return, the taxpayer filed an action in federal district court for the refund asserted in the amended return. The IRS did not issue a timely notice of deficiency based on the tax deduction in its original return with respect to which the taxpayer apparently had claimed.[3] According to the district court opinion, the taxpayer is claiming a refund of \$96 million in its amended return. According to the government complaint, the taxpayer’s liability for tax year 2018 is \$473 million. Although the opinion does not state how much tax was paid for 2018 in the original return, it must have been less than \$473 million. Otherwise, the government would have had no reason to file the common law action.

Aware that the notice of deficiency procedure deadline would expire, the government sued the taxpayer in federal district court based on what it called a common-law right to sue for an outstanding tax debt. The taxpayer then moved to dismiss the government’s complaint on the theory that the federal tax law has only one method for the government to assert an income tax deficiency, and that is a timely notice of deficiency, which the IRS did not issue. Quoting IRC §6213(a), the taxpayer argued that the Internal Revenue Code spells out the exclusive method to assert an income tax deficiency: “[N]o assessment of any tax imposed by subtitle A [income tax] ... and no levy or *proceeding in court* for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer....” (Emphasis added.) The referenced notice is a notice of deficiency issued by the Commissioner.[4]

The court denied the taxpayer’s motion, concluding that the government had a common law right to sue a taxpayer in federal district court for an income tax deficiency. As the government admitted in its brief, however, the cases the district court cited do not address the precise situation presented.[5]

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The court clearly thought that the taxpayer unfairly exploited the federal tax refund litigation procedure by forcing the IRS to stay its administrative examination of the taxpayer's 2018 income tax return: "Defendant cannot seek to profit by compelling litigation in one forum [federal district court] and then complain that it has been deprived some benefit provided by the other forum [United States Tax Court]." The IRS was not, of course, without recourse. It could have timely issued a notice of deficiency. In fact, the Internal Revenue Manual directs the IRS Chief Counsel to protect the right to issue a notice of deficiency.^[6] The IRS did not do so, but perhaps it was a tactical decision to ensure that the federal district court retain jurisdiction. A final decision in the case, when issued following a decision by the district court on the remaining issue of whether the taxpayer is entitled to judgment as a matter of law, will be appealable to the 10th Circuit.

Please contact your Miller Canfield attorney or the authors of this alert if you wish to discuss the issue further.

[1] The mismatch allegedly allowed a taxpayer to claim a dividends received deduction under IRC §245A for tax year 2018 for arguably more of the income of a controlled foreign corporation than was included under IRC §951A.

[2] During this complex litigation, the taxpayer successfully challenged a Treasury Department temporary regulation that prevented a taxpayer from exploiting the mismatch. The district court invalidated the temporary regulation because the Treasury Department issued it without notice and an opportunity of the public to comment on the regulation in violation of the Administrative Procedure Act. The court said that the remaining issue to be decided was whether the taxpayer was entitled to judgment as a matter of law. *Liberty Global Inc. v. United States*, 129 AFTR 2d 2022-1373, (D. Colo. Apr. 4, 2022).

[3] A taxpayer may sue for refund in federal district court if the IRS does not act on the claim within six months of filing the claim. IRC §6532(a)(1). The government possibly did not issue a notice of deficiency as a tactical step. If the IRS had issued a notice of deficiency for the original return, the taxpayer could then have petitioned the U.S. Tax Court to challenge the proposed deficiency, which would have deprived the federal district court of jurisdiction. IRC §7422(e). Perhaps the Government wanted the federal district court to retain jurisdiction and for that reason did not issue the notice of deficiency.

[4] IRC §6212(a).

[5] The court cited *Shelter Mutual Insurance Mutual Ins. Co. v. Gregory*, 555 F. Supp. 2d 922 (2008)(notice of deficiency in fact issued for 2004 and 2005); *Jersey Shore State Bank v. United States*, 107 S. Ct. 782 (1987)(employment tax case for which a notice of deficiency cannot be issued); *United States v. Erie Forge Co.*, 191 F.2d 627 (3rd Cir. 1951) (delinquency penalty for which a notice of deficiency could not be issued); *United States v. Sarubin*, 507 F.3d 811 4th Cir. 2007)(deficiency interest on assessed taxes accrued as a matter of law and was not subject to notice of deficiency procedure); *Damsky v. Zavatt*, 289 F.2d 46 (2nd Cir. 1961)(taxes were previously assessed in this lien foreclosure proceeding); *Marvel v. United States*, 719 F.2d 1507 (10th Cir.1983) (employment tax case which is not subject to the notice of deficiency procedure); *Macatee v. United States*, 214 F.2d 717 (5th Cir. 1954)(employment tax case not subject to the notice of deficiency procedure). In its brief, the Government admits "[n]one of the authorities cited above address the precise situation – though they lay out the general principles the Court should apply."

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[6] The Internal Revenue Manual states, "If the consents [to extend the limitations period] cannot be obtained [from the taxpayer], the Area Director/Director of Field Operations should take any steps appropriate to protect the statute of limitations for assessment, including issuing a statutory notice of deficiency." IRM 34.5.2.4(6).