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IRS Insights
A closer look.
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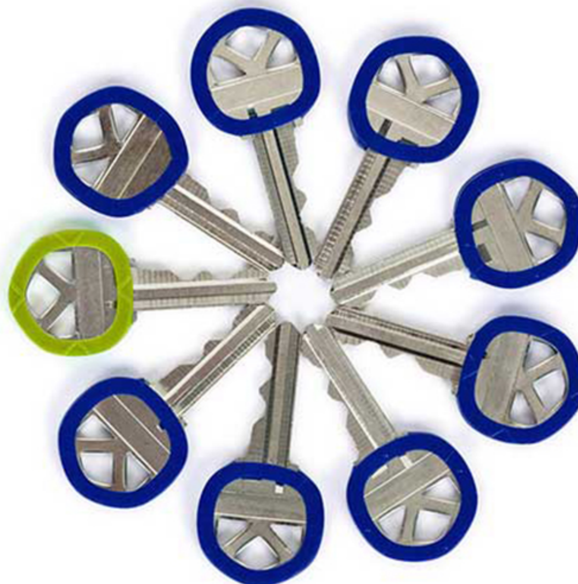

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Nonresident USVI taxpayer "filing" under Section 6501(a)

In *Coffey v. Commissioner*,[1] the Eighth Circuit reviewed an appeal of a Tax Court decision on whether the taxpayers, if nonresidents of the United States Virgin Islands ("USVI"), had "filed" returns with the IRS for purposes of starting the period of limitations on assessment in section 6501(a). The Court concluded that, even though the USVI's Bureau of Internal Revenue sent the taxpayers' return to the IRS, this action did not constitute "filing" within the meaning of Section 6501(a).

[1] *Coffey v. Commissioner of Internal Revenue*, No. 18-3256 (8th Cir. 2020)

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Background

Taxpayers only filed returns with the USVI's Bureau of Internal Revenue claiming to be USVI bona fide residents for 2003 and 2004. For these years, taxpayers' returns consisted of completed Form 1040s, their USVI and federal W-2s, and numerous other schedules and forms. Taxpayers also claimed an Economic Development Commission Program ("EDP") credit for each year.

Although Taxpayers did not separately send these returns to the IRS, the USVI Bureau of Internal Revenue sent the first two pages of their returns and their USVI and federal W-2s to the IRS about five months after receiving these documents. The VIBIR sent these documents to the IRS as a matter of course so that the taxpayers' prepayments to the IRS could then be paid to the USVI.[2]

The IRS examined taxpayers' returns, which resulted in the IRS issuing notices of deficiency to the taxpayers in 2009, more than three years after receiving the documents. The IRS asserted that the taxpayers were never a bona fide resident of USVI and therefore, could not claim the EDP credit. Taxpayers filed suit in Tax Court. Taxpayers argued that any assessment would be time barred because the three-year assessment period in section 6501(a) had expired. Taxpayers moved for summary judgment, assuming as true the fact that taxpayers were not bona fide residents for the tax periods at issue.

The Tax Court granted taxpayers' motion for summary judgment, holding the period of limitations began when the IRS received the documents from the USVI.[3] A concurring opinion stated that the statute of limitations began when the taxpayers filed their USVI returns with the USVI. A dissenting opinion believed that neither the taxpayers or the USVI filed anything with the IRS. The government appealed the Tax Court's decision to the Eighth Circuit.

Law and Court's Analysis

The United States and the USVI are separate taxing authorities. The USVI administers a mirror code of the Internal Revenue Code.[4] Under USVI's Economic Development Program, USVI bona fide residents owe only ten percent of income tax on their income derived from sources within the USVI or income effectively connected with the conduct of a trade or business within the USVI.[5] Taxpayers with USVI-related income have different reporting requirements. Bona fide USVI residents are required to file an income tax return with only the Virgin Islands.[6] Other taxpayers with USVI-related income shall file their income tax returns with both the United States and Virgin Islands.[7]

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[2] *See* I.R.C. § 7654(a)
[3] *Coffey v. Comm'r*, 150 T.C. 60, 97 (2018).
[4] I.R.C. § 932
[5] I.R.C. § 934(b)(1); 29 V.I.C. § 713b(b), (e)(1)(A)
[6] I.R.C. § 932(c)(2), (c)(4)
[7] I.R.C. § 932(a)(2)

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Generally, the IRS must assess tax within three years from the time a return is filed.[8] However, if the taxpayer fails to file a return, the IRS may assess tax at any time. The taxpayers argued that the USVI's Bureau of Internal Revenue sending their tax return to the IRS constituted "filing" a return with the IRS for purposes of section 6501(a). Alternatively, the taxpayer argued that their returns filed with the USVI's Bureau of Internal Revenue alone met the USVI nonresident filing requirement. The Tax Court had agreed with the taxpayers' first argument, concluding that documents had been filed with the IRS and the period of limitations had expired.

The Eighth Circuit began its analysis with the issue of whether USVI's sending of taxpayers' returns to the IRS constituted a "filing" within the meaning of section 6501. The Court noted that neither the Internal Revenue Code nor regulations define the term "file" or "filing". The Court noted the general rule in case-law is that a taxpayer must meticulously comply with the statutory conditions to begin the statute of limitations.[9] Courts also have held that a return is considered filed if it was delivered, in the appropriate form, to the specific individual or individual identified in the Code or Regulations.[10]

Critical to the Court's analysis was the similar case of *Heckman v. Commissioner*.[11] In that case, the IRS learned that the taxpayer did not report some taxable income through an unrelated audit. The IRS issued a notice of deficiency more than three years after the taxpayer had filed the return for the period. The taxpayer argued that the IRS was time barred by section 6501(a) based on the IRS's actual knowledge of the unreported income when the taxpayer filed the return. The court in *Heckman* disagreed, finding that the IRS's actual knowledge did not start the three-year statute of limitations.[12]

Thus, the Eighth Circuit here found, as in *Heckman*, that the IRS's actual knowledge was not a filing. While the IRS received actual knowledge of the taxpayers' information, it did not receive a filing. The taxpayers intended to file their return only with the USVI and failed to meticulously comply with federal filing requirements for USVI nonresidents. Moreover, the Court reasoned that the USVI's Bureau of Internal Revenue did not file taxpayers' returns when they transmitted them to the IRS. The taxpayers never authorized the USVI to file the returns. In addition, the Court found stated that it is irrelevant for statute of limitations purposes that the IRS actually received the documents, processed and audited them, and issued deficiency notices.

The Court then turned to the taxpayers' second argument that their filings with the USVI's Bureau of Internal Revenue began the three-year statute of limitations for assessment. The taxpayers argued that although their filings were imperfect, they should satisfy their burden to file a return under Section 6501(a) because they mode a genuine and honest attempt to file, even if they were mistaken about residency.

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[8] I.R.C. § 6501(a)
[9] *See Lucas v. Pilliod Lumber Co.*, 281 U.S. 245, 249 (1930)
[10] *Comm'r v. Estate of Sanders*, 834 F.3d 1269, 1274 (11th Cir. 2016), quoting *Allnutt v. Comm'r*, 523 F.3d 406, 413 (4th Cir. 2008).
[11] *Heckman v. Comm'r*, 788 F.3d 845 (8th Cir. 2015)
[12] *Id.* At 857

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The Court was not persuaded, finding that the taxpayers' subjective intent was irrelevant in determining what is an honest and genuine return.[13] The Court held that a prerequisite to an honest and genuine return is that it is filed with the correct individual.[14] Furthermore, the Court observed, there is no exception to section 6501 for a taxpayer's mistaken position about residency.[15]

For these reasons, the Eighth Circuit found that the taxpayers had not filed a return within the meaning of section 6501(a). The judgment reversed the Tax Court and remanded the case for proceedings consistent with the opinion.

IRS issues Email Chief Counsel Advisory Memoranda on Refunds and Section 7508A

The IRS recently released two emailed Chief Counsel Advice memoranda[16] (CCA 202053013 dated September 25, 2020, and CCA 202053015 dated October 15, 2020), which provide helpful insights into how the IRS Office of Chief Counsel views the impact of disaster relief under section 7508A on the period of limitations for refund claims under section 6511.

Section 7508A provides that the Secretary of the Treasury has the authority to disregard a period of up to one year for certain tax acts for taxpayers determined by the Secretary to be affected by a federally declared disaster or terroristic or military action. On March 13, 2020, the President issued an emergency declaration under the Robert T. Stafford Disaster Relief and Emergency Assistance Act in response to the ongoing Coronavirus Disease 2019 ("COVID-19") pandemic. On April 9, 2020, pursuant to the emergency declaration and its authority under section 7508A, the IRS issued Notice 2020-23.[17] Notice 2020-23 provided relief to "affected taxpayers" from timely complying with certain tax filing and payment deadlines, as well as postponing specified time-sensitive acts that were due to be performed on or after April 1, 2020, and before July 15, 2020.[18] One of the specified time sensitive acts set forth in Treas. Reg. § 301.7508A-1(c)(1)(v) is the time for filing a claim for credit or refund of any tax.

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[13] *See Zellerbach Paper Co. v. Helvering*, 293 U.S. 172, 180 (1934); *In re Colsen*, 446 F.3d 836, 840 (8th Cir. 2006)
[14] *Comm'r v. Estate of Sanders*, 834 F.3d 1269, 1277 (11th Cir. 2016)
[15] *See Sanders*, 834 F.3d at 1277.
[16] CCA 202053013, CCA 202053015
URL: https://www.irs.gov/pub/irs-wd/202053013.pdf
URL: https://www.irs.gov/pub/irs-wd/202053015.pdf
[17] Notice 2020-23 (located at https://www.irs.gov/pub/irs-drop/n-20-23.pdf)
[18] The specified time-sensitive actions identified in Notice 2020-23 include any time-sensitive action listed in Regs. Secs. 301.7508A-1(c)(1)(iv) through (vi) or Rev. Proc. 2018-58, as well as an investment in a qualified opportunity fund due to be made during the 180-day period described in Sec. 1400Z-2(a)(1)(A).

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Section 6501(a) provides generally that a claim for refund for which a taxpayer is required to file a return shall be filed by the taxpayer within three 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. Section 6511(b)(2)(A) limits the amount of a refund to the portion of tax paid during the three years immediately preceding the filing of the claim, plus the period of any extension of time for filing the return, if the claim was filed during the three-year limitations period. Section 6511(b)(2)(B) limits the amount of a refund to the portion of tax paid during the two years immediately preceding the filing of the claim, if the claim was not filed within the three year period. The periods contained in section 6511(b)(2) are commonly referred to as “lookback periods” as one looks back within either the applicable two or three year period to determine the amount of an overpayment subject to refund.

In the September 25, 2020 memorandum,[19] the IRS Office of Chief Counsel addressed whether the relief provided in Notice 2020-23 will impact the three-year look back period for future refund claims relating to 2019 tax returns. The memorandum explains that, although affected taxpayers had until July 15, 2020, to file their 2019 tax returns, Notice 2020-23 did not affect the date on which any withheld or estimated taxes for 2019 were deemed paid. In other words, any withheld tax or estimated tax for 2019 was still deemed paid on April 15, 2020, for calendar year taxpayers.[20]

In a scenario in which a taxpayer files their 2019 return pursuant to Notice 2020-23 on July 15, 2020, the taxpayer would have until July 17, 2023 (July 15, 2023 is a Saturday), to timely file a refund claim pursuant to the normal three-year refund period in section 6511(a). The three-year lookback period in section 6511(b)(2)(A), however, limits any refund to the amounts paid within the three years prior to the filing of the refund claim plus any period of extension. Importantly, the memorandum notes that the section 7508A postponement provided in the Notice 2020-23 relief is not an extension. Therefore, the IRS position is that the taxpayer must file the refund claim by April 15, 2020, and not wait until July 17, 2023, to obtain a refund of any estimated taxes or withheld amounts in this context.

In the memorandum dated October 15, 2020,[21] the IRS Office Chief Counsel addressed the scenario where a taxpayer filed a refund claim during the section 7508A postponement period. In this scenario, the taxpayer filed a refund claim in 2020 for withholding amounts for the 2016 tax year that were deemed paid on April 15, 2017. If the taxpayer filed a refund claim in June of 2020, then under normal circumstances the withheld amounts would be outside the three-year lookback period. However, due to the section 7508A postponement in Notice 2020-23, a refund claim filed in June 2020, would be considered timely and the postponement operated to disregard the period of April 15, 2020 to June of 2020 for purposes of the section 6511 look-back period. The memorandum cites a helpful example from Treas. Reg. § 301.7508A-1 to further clarify this point.[22]

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[19] CCA 202053013
[20] I.R.C. § 6513(b)(1), IRC § 6513(b)(2)
[21] CCA 202053015
[22] Treas. Reg. §301.7508A-1, Example 5

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Taken together, these two memoranda clarify the IRS's view of how postponements under section 7508A affect refund claims under section 6511 and are a good reminder to ensuring the filing of timely claims.

The Fifth Circuit decides what qualifies as a "return" under Section 6501(a)

In *Quezada v. IRS*,[23] the Fifth Circuit Court of Appeals considered whether the taxpayer filed a "return" that was sufficient to start the period of limitations on assessment. The Fifth Circuit determined that the Form 1040 filed by the Quezadas and the Forms 1099 issued by Mr. Quezada's business to its workers started the running of the assessment statute of limitations for backup withholding.

Mr. Quezada is a general contractor who hires subcontractors to assist in his masonry work. For each subcontractor to whom he paid $600 or more, Mr. Quezada was required to file a Form 1099, *Miscellaneous Income*.[24] The Form 1099 requires the payor, such as Mr. Quezada, to record the Taxpayer Identification Number ("TIN") or social security number of each of the payees.[25] If the payee fails to furnish his TIN to the payor, then the payor must withhold at a flat rate for all payments to the payee ("backup withholding") and record this on a Form 945, *Annual Return of Withheld Federal Income Tax*.[26]

For the tax years 2005 through 2008, Mr. Quezada reported the payments he made to subcontractors working for his business but almost all of the Forms 1099 he filed reporting those payments failed to include the individual's TIN. For each of the years almost all of the Forms 1099 he issued were deficient in this way. Although required, Mr. Quezada failed to backup withhold on the payments he made and failed to file Forms 945 for the relevant tax years. He also failed to indicate on any Form 1099 that he had backup withheld any portion of his payments to subcontractors.

M. Quezada's failures prompted an IRS examination in 2014 that resulted in an assessment of $1.2 million in additional tax for failing to engage in backup withholding for 2005-2008, plus penalties and interest.

Mr. Quezada contested this assessment, arguing that the IRS was assessing tax after the period of limitations expired. Mr. Quezada argued that his Forms 1040 and 1099 constituted a "return" that started the section 6501(a) assessment statute of limitations; therefore, the assessment statute expired prior to the IRS assessment. The IRS disagreed with the premise that Mr. Quezada's Forms 1040 and 1099 combined could constitute "the return" for purposes of section 6501(a). The IRS argued that, under the facts of this case, only the form that is prescribed by treasury regulations for the specific tax liability at issue – here, the Form 945 – can be "the return" that starts the running of the assessment statute of limitations.

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[23] *Quezada v. IRS*, No. 19-51000 (5th Cir. 2020)
[24] *See* Treas. Reg. 1.6041-1(a)(1)(i)(A)
[25] *See* Treas. Reg. 301.6109-1(c)
[26] I.R.C. § 3406(a)

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Mr. Quezada's argument was rejected by the bankruptcy court, which held that the assessment statute had not yet begun to run, which was affirmed by the district court on appeal. In response, taxpayer filed a timely appeal to the Fifth Circuit.

The Fifth Circuit identified one overarching issue at the heart of the case: whether the IRS's assessment of the taxpayer is barred by the three-year limitations period. The Fifth Circuit began its analysis by examining Section 6501(a) which sets out a general rule requiring the IRS to assess tax within 3 years from the time the return was filed.[27] However, if the taxpayer fails to file a return, the IRS may assess tax at any time.[28]

The Court considered whether taxpayer's Forms 1040 and 1099 sufficed as the "return" for purposes of triggering the Section 6501(a) three-year assessment statute for assessing Mr. Quezada's backup withholding liabilities. In weighing the question, the Court turned to caselaw, examining the holding in *Comm'r v. Lane-Wells Co.*[29] In *Lane-Wells Co.*, the taxpayer, a personal holding company, mistakenly filed corporate returns.[30] The IRS assessed tax for the relevant periods more than three years after the taxpayer had filed its returns.[31] Taxpayer argued that the assessments were barred by the three-year limitations period. The Supreme Court sided with the IRS, holding that corporate returns did not start the limitations period.[32]

The IRS anchored its argument on a reading of *Lane-Wells Co.* that it created a rule requiring taxpayers to file the designated return for the tax liability at issue and if a taxpayer fails to do so, then the limitations period does not begin to run.

The Fifth Circuit read *Lane-Wells* differently. The Fifth Circuit observed that according to the Supreme Court's reasoning in *Lane-Wells*, the wrong form can qualify as "the return" so long as the form shows the facts on which the liability could be predicated.[33] The Court noted that the IRS reading of *Lane-Wells* conflicted with the readings of several circuit courts that have recognized that "the return" can be forms other than the one prescribed in treasury regulations.[34] On these grounds, the Fifth Circuit rejected the IRS' reading of *Lane-Wells*, concluding instead that "the limitations clock begins to tick, when the taxpayer files a return that contains data sufficient (1) to show that the taxpayer is liable for the tax at issue and (2) to calculate the extent of that liability."

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[27] I.R.C. § 6501(a)
[28] I.R.C. § 6501(c)(3)
[29] *Comm'r v. Lane-Wells Co.*, 321 U.S. 219, 223 (1944)
[30] *Id.* at 220
[31] *Id.*
[32] *Id.* at 224
[33] *Id.* at 223
[34] *See Eggertsen*, 800 F.3d at 763; *Springfield v. United States*, 88 F.3d 750, 752 (9th Cir. 1996); *Siben v. Comm'r*, 930 F.2d 1034, 1036 (2d Cir. 1991); *Neptune Mut. Ass'n, Ltd. of Bermuda v. United States*, 862 F.2d 1546, 1555 (Fed. Cir. 1988); *Atl. Land & Imp. Co. v. United States*, 790 F.2d 853, 858 (11th Cir. 1986)

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The Court then applied this two-part test to determine if Mr. Quezada's Forms 1040 and 1099 constitute the "return" to start the assessment statute of limitations on the backup withholding tax liabilities. First, the Court concluded that the Forms 1099 filed by Mr. Quezada provided the IRS with the information needed to determine that he was liable for backup-withholding for the payees listed without TINs. Next, the Court concluded that Mr. Quezada's Forms 1040 and 1099 contained data sufficient for the IRS to calculate the extent of Mr. Quezada's backup-withholding liability. The Court reasoned that the IRS could calculate the liability based on the face of the Forms 1099, which showed the payees that were missing TINs and the total amount each payee was paid. The Court observed that the IRS had, in fact, used this precise method to calculate the amount of backup-withholding tax to assess against the taxpayer. Accordingly, the Court concluded that the taxpayer's Forms 1040 and 1099 constituted "the return" for purposes of Section 6501(a) and the IRS's assessment was time barred.

Does failing to file a return constitute advice? What is reasonable reliance on an advisor?

In *Baer v. United States*, the United States Court of Federal Claims considered whether a taxpayer had reasonable cause for failing to timely file his 2011 Form 1040. Taxpayer argued that his failure was due to his tax advisor's misunderstanding of tax law, which resulted in the advisor sending the completed extension to the taxpayer rather than filing it with the IRS. The taxpayer argued that this error constituted erroneous tax advice and therefore, his failure to timely file his return should be excused for reasonable cause. The Court concluded that taxpayer's advisor did not provide substantive advice and that taxpayer could not reasonably rely on it.

Taxpayer, an attorney, engaged a CPA to help prepare his personal income tax returns for the tax year 2009, 2010, and 2011. For each year, taxpayer worked with his CPA to prepare his tax return and obtain an automatic extension of the deadline to file his taxes. For the 2009 tax year, taxpayer's CPA prepared and timely filed a Form 4868, *Application for Automatic Extension of Time To File US Individual Income Tax Return*. However, in 2010, taxpayer's CPA prepared the extension but failed to file it; instead, providing the taxpayer a copy of it.

For the 2011 tax year, taxpayer's CPA again prepared the Form 4868 and sent the completed document to the taxpayer instead of filing it with the IRS. As a result, taxpayer's 2011 tax return was late. The IRS assessed $27,139.14 late filing penalty.[35]

Taxpayer paid the penalty amount and filed a Form 843, *Claim for Refund and Request for Abatement*. The IRS did not act on the taxpayer's refund claim. As a result, taxpayer filed a complaint with the Court of Federal Claims, seeking the abatement of the late filing penalty. Taxpayer argued that, based on industry practice and

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[35] I.R.C. § 6651(a)(1)

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his prior course of dealings with the CPA, it was reasonable and appropriate to expect his CPA to timely file the extension. Taxpayer, noting that Form 4868 does not require the signature of the taxpayer, argued that both the Form's design and industry custom create reasonable expectations that taxpayers can reasonably rely on their agents to timely file an extension.

Alternatively, taxpayer argued that the late filing penalty should be excused for reasonable cause because it resulted from his CPA's misunderstanding of the applicable tax law. Taxpayer asserted that the reason his CPA sent the completed extension to him was because his CPA mistakenly believed that taxpayer needed to pay his balance due with his extension request. Taxpayer contended that his reliance on the CPA's misunderstanding of tax law qualified for reasonable cause.

The court began its analysis by revisiting the Supreme Court's seminal ruling in *United States v. Boyle*.[36] The court recounted that in *Boyle*, the Supreme Court held that taxpayers retain the obligation to ascertain and meet any statutory deadlines and that taxpayers' failures cannot be excused by the reliance on agents.[37] The court held that the law is constrained by this precedent, not industry practices, and the taxpayer cannot discharge to his agent a non-delegable duty of the taxpayer.

Next, the court turned to the taxpayer's second argument that his failure to timely file his tax return should be excused for reasonable cause because he relied to his detriment on his CPA's misunderstanding of the applicable tax law. The Court stated that when a taxpayer relies on a tax advisor, his personal liability for noncompliance turns on whether the advisor was providing mere ministerial assistance or substantial advice on tax law. As the court noted, when a taxpayer engages an adviser to assist in preparing and filing a tax return, the taxpayer remains liable for any ministerial acts, such as filing the tax return by an applicable deadline.[38] In its analysis, the Court honed in on the distinction between providing mere ministerial assistance or substantive advice on tax law, reasoning that it is reasonable to excuse taxpayers from liability for relying on the advice of an attorney or accountant on matters of tax law because many taxpayers are not competent to discern errors in substantive advice. In its analysis, the court noted that the taxpayer was conflating the provision of legal advice with his CPA's conduct and that at no point did the CPA advise taxpayer that he had to make his payment with his extension. Accordingly, the court held that the Taxpayer could not absolve his responsibility to timely file his tax return by equating a ministerial act with the provision of substantive advice. Moreover, the court ruled that even if the CPA's conduct constituted advice, it would be unreasonable for the taxpayer to rely on it.[39] The court observed that the face of the Form 4868 suggests that making a payment in conjunction with the extension is optional. Therefore, even if it was to accept, the taxpayer's allegation that his CPA gave erroneous advice, it was not reasonable and cannot excuse the taxpayer's failure to perform his non-delegable duty.

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[36] *United States v. Boyle*, 469 US 241 (1985)
[37] *Id.* At 249-250
[38] *McMahan v. C.I.R.*, 114 F.3d 366 (2d. Cir. 1997)
[39] *See Stobie Creek Invs. LLC v. United States*, 608 F.3d 1366, 1381 (Fed. Cir. 2010)

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