Does A Civil Penalty Time Bar Apply In The Tax Context?

By **Armando Gomez, Alan Swirski and Keith Neely** (November 27, 2018, 3:18 PM EST)

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Does the Internal Revenue Service have an unlimited period of time to assess penalties against alleged promoters of abusive tax shelters? That's the question posed to the U.S. Court of Appeals for the Seventh Circuit in a potentially pivotal case slated for argument next month: Philip Groves v. U.S.[1] For decades, the IRS has taken the view that promoter penalties imposed pursuant to Internal Revenue Code Section 6700 are not subject to a statute of limitations because the code does not expressly provide for one. Perhaps surprisingly, courts have historically agreed with the IRS.[2]

But in recent years, the Supreme Court has signaled that it is no longer willing to grant administrative agencies the power to assess penalties in perpetuity. In both Gabelli v. SEC,[3] and Kokesh v. SEC,[4] the court relied on the catch-all statute of limitations contained in 28 U.S.C. Section 2462 to impose a strict five-year time bar on penalty enforcement actions brought under the securities laws.

Perhaps recognizing the shifting legal landscape, Groves has asked the Seventh Circuit to consider this narrow legal question in light of the more recent Supreme Court decisions.[5] Two amicus briefs were filed in support of Groves, reinforcing his argument that both the plain language of the statutory text as well as the historic policies underpinning statutes of limitation support the application of 28 U.S.C. Section 2462 in the promoter penalty context.

Background of the Dispute

IRC Section 6700 permits the IRS to assess penalties against any person involved in the promotion of abusive tax shelters. These penalties can be quite substantial: 50 percent of the gross income derived from the use of the shelter.[6] The procedure for challenging these penalties makes them even more burdensome because the "deficiency procedures" that allow most tax contests to be heard by the U.S. Tax Court on a prepayment basis do not apply.[7] Instead, to contest the IRS' assessment the alleged promoter must first pay 15 percent of the assessed penalty and then file a claim for refund.[8] The statute itself does not expressly provide for a limitations period in which to bring an assessment, although the code does require that the penalty be collected within 10 years of its assessment.[9]

In this case, the IRS assessed $2.38 million in penalties in 2015 against Groves for conduct that allegedly took place in 2004 and 2005. He followed the statutorily prescribed method for challenging the penalty and brought a suit for refund in the Northern District of Illinois, claiming that the penalty assessment was untimely. The government filed a motion to strike that portion of his suit as meritless, and the district court agreed. Recognizing that disagreement on the point existed, however, the district court granted Groves' petition for interlocutory review and certified the case for appeal.

Key Questions on Appeal

On appeal, Groves again raised two of the three arguments that had been rejected by the district court.[10] First, he argued that the five-year statute of limitations in 28 U.S.C. Section 2462 applied in the promoter penalty context. Second, he argued that the equitable doctrine of laches similarly applied to bar the IRS from assessing penalties over too long a period of time.

Regarding the applicability of Section 2462, Groves first set the stage by noting the historic importance of statutes of limitation, particularly as applied against the government. Citing an opinion of Chief Justice John Marshall, he argued that it would be "utterly repugnant to the genius of our laws" if actions for penalties could "be brought at any distance of time."[11]

Turning then to the language of the relevant statutes, Groves raised two textual arguments. First, he addressed the absence of an express limitation provision within the IRC Section 6700. Pointing to other provisions in the tax code — provisions where Congress expressly provided for an unlimited statute of limitations — Groves argued that if Congress intended Section 6700 penalties to be imposed over any distance of time, it would have included language to that effect in the statute.[12] Groves then argued that a penalty assessment under IRC Section 6700 qualifies as an "action, suit or proceeding for the enforcement of any … penalty" within the meaning of 28 U.S.C. Section 2462. Although appearing a simple proposition on its face, a more careful reading of the statute reveals several nuanced hurdles on this issue. For starters, the IRS assesses promoter penalties ex parte, making it unclear whether an assessment qualifies as an "action, suit or proceeding" within the meaning of the statute. Moreover, because collection of the penalty occurs separately, there is a colorable argument that the assessment is not a part of the enforcement process.

Recognizing these challenges, Groves' brief unpacked the language of Section 2462 and the history of IRC Section 6700. Pointing to a number of Supreme Court decisions involving tax assessments, his counsel argued that the Supreme Court has historically considered the IRS' tax deficiency and penalty collection process to be a "proceeding that is in substance an action equivalent to a suit."[13] Moreover, other circuits have held that analogous administrative penalty proceedings are considered a part of the enforcement process within the meaning of Section 2462.[14]

Acknowledging that other circuits had reached different conclusions regarding the applicability of Section 2462, Groves' counsel encouraged the Seventh Circuit to follow the reasoning laid out in a Sixth Circuit dissent authored by Judge Danny Boggs in 1992. In that dissent, Judge Boggs argued that "[t]he assessment is a prerequisite to, and thus part of, the measures for the enforcement of a civil penalty. It would seem quite odd to say that the very act that initiates the actions leading to the collection of the penalty, a stream of events that must at some point be a proceeding, is not itself part of the proceeding."[15]

The amicus brief that we filed on behalf of the American College of Tax Counsel argued in support of application of Section 2462 for several policy reasons, including to ensure that cases are brought timely, before evidence and memories are stale. ACTC also encouraged the Seventh Circuit to recognize that the Supreme Court has recently rejected the doctrine of "tax exceptionalism," which is the idea that tax laws are somehow special and should not be subject to the same generally applicable legal principles that apply to other areas of general administrative law.

A separate amicus brief filed jointly by the Harvard Law School Federal Tax Clinic and the Philip C. Cook Low-Income Taxpayer Clinic at Georgia State University College of Law illustrated the potential negative consequences that the district court's opinion would have low-income taxpayers. Specifically, they argued that the failure to apply a statute of limitations on so-called "assessable penalties" can lead to particularly unjust results for low-income taxpayers who cannot pay and would be without any opportunity to contest the penalties.

Does Time Run Against the King?

In addition to advancing mirroring arguments, the government raised a pair of additional unique arguments in its opposition brief.

First, in a move designed to blunt Groves' policy arguments in favor of statutes of limitation, the government noted the long-standing rule that statutes of limitation are to be strictly construed in favor of the government. This legal principle, which the government traces to the common law maxim *nullum tempus occurrit regi* — meaning no time runs against the king— appears frequently in Supreme Court case law and stands in stark opposition to Chief Justice Marshall's observations in Adams.[16]

Second, the government argued that whether a penalty assessment qualified as an "action, suit or proceeding" within the meaning of Section 2462 was irrelevant; the catch-all statute of limitations was inapplicable because Congress had "otherwise provided" for an applicable limitations period. Pointing to the 10-year window in which the government must collect penalties once assessed, the government took the position that this "comprehensive statutory scheme" places penalty assessments outside the scope of Section 2462. Even though an assessment "may occur at any time," rendering the 10-year collections limit largely meaningless, the government argued that "[n]early every limitations period runs from the occurrence of some event whose timing is uncertain."[17] The problem the government faces with this argument, however, is that the code distinguishes between statutes of limitation on assessment and statutes of limitation on collection, and the government may have an uphill battle in convincing the Seventh Circuit that the latter can also be counted as the former.

Clues at Oral Argument

Oral argument in this case, scheduled for Dec. 3, 2018, may provide observers with some early clues about the panel's leanings. An early test for Groves will be whether its textual arguments have any traction with the judges, especially given the uphill battle he faces in existing case law. On the other side, the government may have a difficult time convincing the judges that the 10-year limit on collecting assessments is anything more than a meaningless formality, especially given that the government holds the view that the IRS may assess penalties at any time.

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[1] Philip Groves v. U.S., No. 17-2937

[2] See, e.g., Capozzi v. United States, 980 F.2d 872 (2d Cir. 1992); Lamb v. United States, 977 F.2d 1296 (8th Cir. 1992); Mullikin v. United States, 952 F.2d 920 (6th Cir. 1991)

[3] Gabelli v. SEC, 568 U.S. 442 (2013)

[4] Kokesh v. SEC, 137 S. Ct. 1635 (2017)

[5] Groves also argues that the equitable doctrine of laches similarly imposes a time limit on IRS assessment of penalties.

[6] IRC § 6700(a)(2)(B)

[7] IRC § 6703(b)

[8] IRC § 6703

[9] IRC § 6502

[10] Groves elected not to re-raise an argument regarding the applicability of IRC § 6501.

[11] Appellant's Br. at 11 (quoting Adams v. Woods, 6 U.S. (2 Cranch) 336, 342 (1805)).

[12] Id. at 14-15.

[13] Id. at 19 (citation omitted).

[14] Id. at 26 (citing 3M Co. v. Browner, 17 F.3d 1453 (D.C. Cir. 1994); Fed. Election Comm'n v. Williams, 104 F.3d 237 (9th Cir. 1996)).

[15] Id. at 33-34 (quoting Mullikin v. United States, 952 F.2d 920 (6th Cir. 1991) (Boggs, J., dissenting)).

[16] Appellee's Br. at 31-36.

[17] Id. at 50.
