A SWITCH IN TIME: THE SIXTH CIRCUIT EXAMINES THE LIMITATIONS PERIOD FOR THE PROHIBITED ALLOCATION EXCISE TAX, PART II

Posted on **September 21, 2015** by **Jim Malone**

On Tuesday, September 15, I reported on a recent Sixth Circuit opinion *Law Office of John H. Eggertsen, P.C. v. Commissioner*, No. 14-2591, 2015 U.S. App. LEXIS 15930 (6th Cir. Sept. 8, 2015), which dealt with a substantive issue under Section 4979A of the Internal Revenue Code, as well as the relevant limitations period. The limitations issue is interesting because there were two statutes that might control and because the government flip-flopped on which should apply.

Although there was an express provision in Section 4979A, the Sixth Circuit concluded that the general assessment limitation in Section 6501(a) applied and that the excise tax was assessed on a timely basis, as the taxpayer had failed to file the requisite excise tax return. *Eggertsen*, 2015 U.S. App. LEXIS 15930, at *11. Moreover, the returns filed by the taxpayer and the employee stock option plan (ESOP) did not provide the IRS with sufficient information to assess the excise tax. *Id.* at *11-*13.

The Court of Appeals did not develop the rationale for applying Section 6501 instead of Section 4979A(e)(2)(D), which gives the IRS three years to assess the excise tax, measured from the later of the illegal allocation or the date that the government is notified of the allocation. The Tax Court had originally ruled that Section 4979A(e)(2)(D) controlled, but it granted reconsideration when the government changed its position. *See Law Office of John H. Eggertsen, P.C. v. Comm'r*, 143 T.C. 265, 268-71 (2014). After reconsideration, the court concluded that it had made a substantial error of law because "we concluded implicitly . . . that . . . a specific statute applicable to the excise tax imposed under section 4979A(a) took precedence over Section 6501, a general statute . . . ." *Id.* at 271.

Instead, the Tax Court ruled, "Section 4979A(e)(2)(D) serves only to extend . . . the period of limitations prescribed by section 6501." Id. (citing *BLAK Invs. v. Comm'r*, 133 T.C. 431, 435-36 (2009); *Rhone-Poulenc Surfactants & Specialities*, L.P., 114 T.C. 533, 542-43 (2000)). These two cases deserve analysis because the conclusion reached by the Tax Court is plausible, but not self-evident.

Neither case had anything to do with ESOPs in general or Section 4979A in particular. Instead, they were partnership cases dealing with the interplay between the general assessment limitations period under Section 6501 and the partnership specific one under Section 6229. *See BLAK Invs.*, 133 T.C. at 437; see also *Rhone-Poulenc*, 114 T.C. at 540-42, 544. Both cases ruled that Section 6229 of the Code extended the general period of Section 6501.

With that as background, it is worth comparing the relevant statutes. Section 6229 provides generally that the time to assess additional tax with respect to a partnership item "shall not expire" for a minimum of three years and that the period runs from the later of the date the partnership return was filed or the date when the return was due (without considering any extensions). I.R.C. § 6229(a). As with Section 6501, there are a variety of potential exceptions, including cases in which the IRS makes an administrative adjustment after examining a partnership return; once a final partnership administrative adjustment notice is issued, the statute of limitations is suspended for the period in which an action can be brought under Section 6226 (authorizing judicial review of final partnership administrative adjustments), during the pendency of the relevant judicial proceeding, and for one year thereafter). I.R.C. § 6229(d).

In turn, Section 6501(n) of the Code lists some explicit cross-references, including the following: "For extension of period in the case of partnership items (as defined in section 6231(a)(3)), see section 6229." I.R.C. § 6501(n)(2). In *Rhone-Poulenc*, the court pointed to both the language in Section 6229(a) that the period to assess tax associated with partnership items "shall not expire" and to the express cross-reference in Section 6501(n)(2) as support for the conclusion that Section 6229 served to extend the time period under Section 6501. 114 T.C. at 542.

In contrast, while Section 4979A does contain the same "shall not expire" language that appears in Section 6229(a), there is no corresponding cross-reference in Section 6501(n), an omission which would seem to weaken, to some degree, the argument that Section 4979A extends the limitations period under Section 6229. Thus, while the Tax Court may have reached the correct result, there appeared to be some room for debate, particularly given the fact that the government had initially argued that Section 4979A was the exclusive limitations period and the Tax Court had agreed.

The Sixth Circuit was examining whether the Tax Court abused its discretion in granting reconsideration to the government, and it noted that "committing an error of law . . . is itself an abuse of discretion." *Eggertsen*, 2015 U.S. App. LEXIS 15930, at *17 (citations omitted). Consequently, it is troubling that the court of appeals did not take the time to explain why Section 6501 controlled.

The balance of the Sixth Circuit's opinion dealt with the question of whether the government was barred from changing its position on the correct limitations period by the doctrine of judicial estoppel. While the shift in the government's position is troubling, the court's ruling that it was not

estopped appears proper. The dissent would have remanded with a directive that the Tax Court examine judicial estoppel in greater detail, but it reads more like a plea that the government be held to a higher standard. *Eggertsen*, 2015 U.S. App. LEXIS 15930, at *20-*24 (Clay, J. dissenting).

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