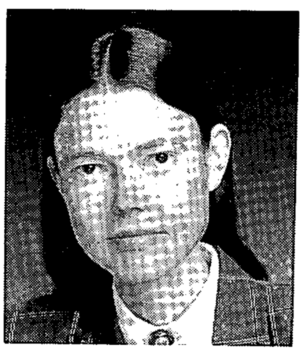
Equitable Exceptions to The Statutes of Limitations: Recoupment, Estoppel, and Tolling

Janet A. Meade examines contemporary applications of common law doctrines.



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Introduction

The Internal Revenue Code establishes specific periods of time, or statutes of limitations, within which all taxes must be assessed and collected, and all refund claims must be filed. After the pertinent statute of limitations expires, the Service is prohibited from assessing or collecting additional taxes, and the taxpayer is barred from claiming a refund or credit of overpaid taxes.

The basic statute of limitations for income, estate, and gift taxes requires that assessments be made within three years of the date a return is filed or of the unextended due date, whichever is later.[1] Claims for credits or refunds of overpaid taxes must be filed within the later of three years from the time a return is filed or two years from the time the taxes are paid.[2] Several exceptions to the basic three-year statute of limitations, however, exist. Although most of these exceptions are statutory in nature, three common law doctrines based on equitable considerations have emerged as judicial remedies for inconsistent or inequitable application of the statutes of limitations. These common law doctrines, however,

[1] IRC Secs. 6501(a) and 6501(b)(1).
[2] IRC Sec. 6511(a).

are often overlooked or ignored by many taxpayers and tax advisers because of a lack of familiarity with the specific circumstances in which they may apply.

This article examines the circumstances under which the three common law doctrines of equitable recoupment, estoppel, and tolling may be applicable. Before so doing, however, it first provides a brief overview of the most common statutory exceptions to the basic three-year statute of limitations, including the mitigation provisions of Sections 1311 through 1314. After presenting this overview, the article describes the requirements of the common law doctrines and explains how these requirements have been recently interpreted by the courts.

Statutory Exceptions

The basic three-year statute of limitations is subject to numerous statutory exceptions. Among the most important of these are situations where a taxpayer:

1. files a false or fraudulent return;
2. fails to file a return;
3. files a return that omits more than 25 percent of gross income;
4. files a claim for refund attributable to a business bad debt, worthless security, or carryback of certain items;
5. requests a prompt assessment of a tax liability from the Service; or
6. agrees with the Service to waive the statute of limitations and extend the assessment period.

In addition, under limited circumstances special mitigation provisions permit the reopening of a statute of limitations to allow for consistent treatment of certain multi-year transactions.

Generally, the statutory exceptions, such as those enumerated above, are mandatory and do not allow for judicial interpretation. Thus, where a taxpayer files a false or fraudulent return with the intent to evade tax, Section 6501(c)(1) provides that the tax may be assessed and collected at any time after the return is filed. Likewise, where no return is filed, Section 6501(c)(3) provides for an unlimited period of assessment and collection.

In situations where gross income is understated by more than 25 percent or a refund claim arises from a business bad debt, worthless security, or carryback of a net operating loss, capital loss, or business tax credit, the basic three-year statute of limitations is supplanted by longer periods. For omissions from gross income in excess of 25 percent, Section 6501(e)(1) extends the statutory assessment period to six years. For refund claims attributable to losses sustained from business bad debts or worthless securities, Section 6511(d) extends the statutory filing period to seven years. Additionally, for refund claims arising from carrybacks of net operating losses, capital losses, research credits, and certain other business credits, Sections 6511(d)(2) and 6511(d)(4) extend the statutory filing period to three years from the extended due date of the return for the year giving rise to the carryback.

Written requests for prompt assessment, when allowed under Section 6501(d), shorten the basic three-year period to 18 months. The procedural prerequisites for filing such requests, however, are extremely specific and are permitted only for an income tax return of a decedent or an estate, or for a corporation in the midst of a dissolution.[3] In contrast, the period of limitations on the assessment of any tax other than an estate tax may be extended to either a specific date or an indefinite period under Section 6501(c)(4) when both the taxpayer and the Service agree in writing to do so.[4]

Mitigation Provisions. In addition to the preceding exceptions to the basic three-year limitation period, numerous other statutory exceptions exist.[5] Only the mitigation provisions of Sections 1311 through 1314, however, attempt to achieve the equitable objective of opening a closed tax year in order to correct an error in the treatment of an item. But before these provisions apply, four conditions must be met. First, a determination for an open year, such as a final judicial decision or administrative action regarding the treatment of an item, must establish that the same item has been treated erroneously in another year. Second, the circumstance of the erroneous treatment must be one of the following seven conditions defined in Section 1312:

1. Double inclusion of an item of gross income.
2. Double allowance of a deduction or credit.
3. Double exclusion of an item of gross income, either with the tax paid or unpaid.

[3] Requests for prompt assessment must be made on Form 4810 and must meet one of two circumstances: (1) there is a tax (other than estate tax) for which a return is required and for which a decedent or an estate of a decedent may be liable; or (2) there is a tax for which a return is required and for which a corporation that is contemplating dissolution, in the process of dissolution, or dissolved may be liable.

[4] Consent Form 872 extends the statute of limitations for a fixed period of time, whereas Form 872-A extends the statute of limitations for an indefinite period.

[5] For a more complete discussion of the statutory exceptions to the basic three-year limitation period, see Dale, "Statute of Limitations," *Tax Management Portfolio* No. 28-5th (1993).

4. Double disallowance of a deduction or credit.
5. Correlative deductions and inclusions for trusts or estates and legatees, beneficiaries, or heirs.
6. Correlative deductions and credits for certain related corporations.
7. Basis of property after erroneous treatment of a prior transaction.

Third, on the date of the determination, correction of the error in the closed year must be barred by some provision or rule of law, such as the statute of limitations on filing a refund claim or an assessment. Fourth, the position adopted in the determination to support either the taxpayer or Service (whomever is the successful party) must be a position that is inconsistent with the position maintained by that same party for the item in the closed year.

When the preceding four conditions are met, Section 1311 permits the error to be corrected by either (1) attributing income or deductions to the correct year and/or taxpayer or (2) establishing the correct basis of property. Such statutory corrections, however, are only allowable for income taxes and errors related to a single item occurring in different years. Situations involving estate, gift, employment, or other taxes are not covered. Similarly, no corrections are allowed for errors related to different items occurring in the same year. Thus, circumstances frequently may arise in which the statutory mitigation provisions are inoperative. Under such circumstances, judicial relief nonetheless may be available through application of the doctrines of equitable recoupment, estoppel, or tolling.

Equitable Recoupment

The common law doctrines of recoupment, estoppel, and tolling are intended to prevent inequitable results arising from exploitation of the statute of limitations. Because they do not supersede the mitigation provisions of Sections 1311 through 1314, however, these equitable doctrines can only be applicable in situations not covered by statutory mitigation, such as claims involving taxes other than income taxes. Moreover, when applicable, they generally are narrowly interpreted to avoid undermining the mitigation provisions.

The doctrine of equitable recoupment provides that when one transaction or taxable event is subjected to two taxes based on inconsistent legal theories, an otherwise time-barred claim may be resurrected to prevent unjust taxation of the transaction as a whole. Although the doctrine is defensive in nature, it may be invoked by either the taxpayer to recover a twice paid tax or the Service to prohibit tax avoidance. The doctrine, however, may only be raised in conjunction with a tax dispute that is not barred by the statute of limitations. Accordingly, the following three criteria must be satisfied for the doctrine to be applicable:

1. The taxable event claimed upon and the one considered in recoupment must arise out of a single transaction;
2. The single transaction must be subjected to two taxes based upon inconsistent legal theories; and
3. The amount claimed in recoupment must be barred by the statute of limitations while the litigated amount must be timely.

Time-barred Claims. Recently, most courts have declined to apply the doctrine of equitable recoupment because one or more of the necessary criteria have not been satisfied. This trend has been particularly prevalent since *Dalm*,[6] in which the Supreme Court stressed the third criteria by holding that the doctrine of equitable recoupment cannot be the sole basis for jurisdiction. In this case, the taxpayer was the executrix of her deceased employer's estate and, while serving in this position, received commissions for services she rendered for the estate. She also received additional payments from the decedent's heirs which were treated as gifts and for which gift taxes were paid. Upon audit, the Service recharacterized the gifts as commissions, taxable as income to the taxpayer. The taxpayer, however, disagreed with the Service's income tax assessment on the purported gifts and filed a petition with the Tax Court. Following an out-of-court settlement and payment of additional income tax, the taxpayer filed a refund claim for the gift taxes. This claim, however, was denied by the Service because the statutory filing period had expired. Claiming equitable recoupment, the taxpayer proceeded to litigate the claim.

The Supreme Court's decision for the Service in *Dalm* emphasized that equitable recoupment can-

[6] *Frances L. Dalm*, 90-1 USTC ¶ 50,154, 494 US 596 (1990). For earlier Supreme Court decisions involving the doctrine of equitable recoupment, see *Ernst M. Bull*, 35-1 USTC ¶ 9346, 295 US 247 (1935); *Robert G. Stone*, 37-1 USTC ¶ 9303, 301 US 532 (1937); *D.W. McEachern*, 37-2 USTC ¶ 9531, 302 US 56 (1937); and *Electric Storage Battery Company*, 47-1 USTC ¶ 9106, 329 US 296 (1946).

not stand alone as the grounds of a separate refund claim. Instead, the doctrine can only be asserted as a defense in a timely action involving another inconsistent tax arising from the same transaction. If a taxpayer consequently seeks to invoke the doctrine of equitable recoupment for a time-barred tax claim, he/she must advance that claim only in conjunction with litigation of a current assessment involving the same, but inconsistently taxed transaction.

Since *Dalm*, several other court decisions also have emphasized the importance of invoking equitable recoupment in conjunction with a current assessment. For example, in *Blohm*[7] the taxpayer was assessed additional tax on unreported income from kickbacks he had received illegally. The kickbacks, however, were related to income from the forgiveness of indebtedness which he had erroneously reported and on which he had paid taxes in another year. Believing that the Service's assessment of tax on the kickback income resulted in a form of double taxation, the taxpayer filed a refund claim for the tax paid on the forgiveness of indebtedness income. This claim, however, was denied by the Service because it was barred by the statute of limitations. The taxpayer then proceeded to litigate the refund claim, not the assessed deficiency.

Following the reasoning in *Dalm*, the district court held in *Blohm* that it lacked jurisdiction to apply the doctrine of equitable recoupment because the taxpayer had failed to invoke it as a defense in conjunction with the assessed deficiency. The only issue before the court, therefore, was the time-barred claim for refund of the taxes paid on the forgiveness of indebtedness income. Lacking jurisdiction to examine the transaction as a whole, the court consequently determined that it could not consider the equitable recoupment claim.[8]

Lack of jurisdiction also was the reason for rejection of the taxpayers' claims for equitable recoupment in *Elliott*[9] and *Bedell.*[10] In both of these cases, the taxpayers attempted to invoke equitable recoupment offensively rather then defensively. As such, their claims were denied as being barred by the statute of limitations. Time-barred claims for equitable recoupment were similarly sought in *Devich*[11] and *Forma.*[12] These claims, however, were denied because they did not involve circumstances in which a single transaction was subjected to two inconsistent taxes. Instead, the tax deficiencies assessed by the Service were merely additional amounts connected with transactions spanning several years.

Satisfying the Criteria. Despite an apparent trend of the courts to restrict application of the doctrine of equitable recoupment, the recent decision of the Second Circuit in *Connecticut National Bank*[13] illustrates that when all of the necessary criteria are satisfied, the doctrine can produce favorable results for the taxpayer. In this case, the terms of a decedent's will divided his residuary estate into marital and residuary trusts, with his wife named as the beneficiary. The wife also was given an income interest in the trusts and a general power of appointment over the corpus of the marital trust. When the wife died, approximately five years later, no distributions had been made from the decedent's estate to either trust. However, one and a half years after the wife's death, the decedent's estate sold stock at a substantial gain and distributed a portion of the proceeds to the marital trust. This distribution was included as an asset for purposes of the wife's estate tax return because of the general power of appointment over the trust corpus, and its value was determined by treating it as a pecuniary (fixed-dollar) bequest from the decedent. Correspondingly, in the year of the stock sale the transaction also was reported on the fiduciary income tax return of the decedent's estate, with the gain computed by using a basis for the stock equal to its value at the time of the decedent's death.

Upon audit by the Service, the distribution to the marital trust was treated as a fractional share bequest that entitled the wife's estate to a proportional share in the residuary assets of the decedent's estate. The Service, therefore, increased the value of the wife's estate substantially and assessed over $3 million of additional estate tax. This additional tax subsequently was paid by the wife's estate. However, one year later the executor of the decedent's estate filed a claim for refund of the income tax paid on the gain from the sale of the stock. This refund, the executor contended, arose from the inconsistency in the determination of the basis of the stock for pur-

[7] *Nelson M. Blohm*, 93-1 USTC ¶ 50,106 (DC-Ala.).

[8] The court did consider the refund claim under the statutory mitigation provisions. Under these provisions, it concluded that the outcome of the claim could not be determined until a final decision concerning the tax on the kickback income was reached by the Eleventh Circuit. The ultimate outcome of the claim, therefore, is still pending.

[9] *William T. Elliott*, 91-2 USTC ¶ 50,583 (DC-Ca).

[10] *Leah Bedell*, 91-1 USTC ¶ 60,057 (DC-NY).

[11] *Matthew M. Devich*, 93-1 USTC ¶ 50,196 (DC-Colo.).

[12] *John Forma*, 92-1 USTC ¶ 50,156, 784 FSupp 1132 (DC-NY).

[13] *Connecticut National Bank*, 92-1 USTC ¶ 50,265 (DC-Conn.), rem'd from 91-2 USTC ¶ 50,348, 937 F2d 90 (CA-2), rev'g and rem'g 90-2 USTC ¶ 50,526 (DC-Conn.).

poses of the wife's and decedent's estates. In essence, the executor argued that because the Service had attributed to the wife's estate one half of the value of the stock held in the marital trust of the decedent's estate, his estate was consequently entitled to use a stepped-up basis to calculate the gain from the stock sale. The Service rejected the claim, however, on the grounds that all of the criteria for equitable recoupment were not satisfied.

The Second Circuit ruled in favor of the decedent's estate. In reaching this decision, it concluded that because Section 1014(b)(4) entitled the beneficiaries of the marital trust, as named in the wife's will, to value any capital gains they might make on sales of marital trust property by using a basis calculated at the time of the wife's death, the decedent's estate also was entitled to use a basis calculated at the time of the wife's death in valuing sales of marital trust assets made after her death. The Service's determination of the basis of the stock, therefore, was held to be inconsistent for purposes of assessing income and estate taxes against the two estates. Moreover, since only a claim for refund of the additional estate tax paid by the wife's estate was barred by the statute of limitations, the court had jurisdiction to determine whether the income tax refund sought by the decedent's estate was allowable under the doctrine of equitable recoupment. Given these facts, it consequently concluded that the Service could not invoke equitable recoupment as a defense against the refund claim of the decedent's estate.

Equitable Estoppel

A second common law doctrine that provides for the equitable remedy of inconsistencies otherwise barred by the statute of limitations is estoppel. Equitable estoppel is based on a duty of consistency; that is, a party should not be allowed to found a claim on another's failure to act if he/she induced the omission or nonperformance by his/her own inequity or wrong. Before the doctrine of estoppel can be invoked in a tax case, however, the following four common law elements must be present:

1. A willful or negligent misrepresentation of fact;
2. Ignorance of the true facts by the party asserting estoppel;
3. Reasonable reliance upon the misrepresentation by the ignorant party; and
4. A detriment suffered because of the ignorant party's reliance.

Claims based on the doctrine of equitable estoppel generally involve either faulty advice by IRS agents or changes in a taxpayer's position after execution of an informal settlement agreement. In either situation, the courts usually decide in favor of the Service for one of three reasons:

1. the taxpayer's reliance on the agent's misstatement is not reasonable and/or sufficiently detrimental;
2. the Service is not bound by the unauthorized acts of its agents; or
3. the execution of an informal settlement agreement is binding and precludes subsequent changes in position.

Faulty Advice. A recent example of the application of equitable estoppel in a tax case dealing with erroneous advice by IRS agents is *Dillard.*[14] In this case, the taxpayers did not file tax returns for the years 1983 through 1988, but did pay excessive amounts of tax for these years through withholding. Upon a subsequent audit by the Service, a settlement was reached that resulted in refunds for the years 1983 through 1986. The taxpayers also were informed by IRS agents during the settlement negotiations that no action would be taken by the Service for the years 1987 and 1988 until the IRS Appeals Office in Washington set a date to hear the case for those two years. Following this advice, the taxpayers did not file tax returns for the years 1987 and 1988 until 1991, when other action by the Service prompted them to claim refunds for both years. After reviewing the claims, however, the Service allowed only the 1988 refund; the 1987 refund claim was disallowed because the statute of limitations had expired.

In reaching a decision for the Service, the Tax Court reasoned that although the advice of the IRS agents regarding the years 1987 and 1988 was erroneous in failing to consider the statute of limitations, the taxpayers' reliance on the misstatement was neither reasonable nor sufficiently detrimental to warrant application of the doctrine of equitable estoppel. Instead, the court held that the taxpayers should have known it was necessary to prepare tax returns for the IRS Appeals hearing based on their experience with the Service for the years 1983 through 1986. Their inaction regarding the years

[14] *Edward B. Dillard*, CCH Dec. 48,044(M), 63 TCM 2255.

1987 and 1988, therefore, was inappropriate under the circumstances.

Similar conclusions also were reached in *First Alabama Bank*[15] and *Meyer.*[16] In *First Alabama Bank,* the Eleventh Circuit determined that the co-executors of the estates of the taxpayers could not have reasonably relied on the misleading oral statements of IRS agents regarding extensions of the statute of limitations because Section 6532(a) requires all such extensions to be in writing. Likewise, in *Meyer,* a district court rejected the taxpayers' claim of equitable estoppel arising from detrimental reliance on erroneous IRS advice because the advice was received by phone and not in writing. The court consequently found that the taxpayers had no recourse against the Service for their failure to file a timely refund claim because their receipt of advice during phone conversations did not satisfy the requirement of Section 6404(f) for written advice. Any reliance they might have placed on the advice, therefore, could not have been either reasonable or sufficiently detrimental to warrant application of the doctrine of equitable estoppel.

As an alternative to determining whether the taxpayer's reliance is reasonable and/or sufficiently detrimental, many courts have rejected estoppel claims against the Service on the grounds that it cannot be bound by the unauthorized statements of its agents.[17] One recent example of such a case is *Miller.*[18] In *Miller,* the Fourth Circuit determined that the doctrine of equitable estoppel could not be applied to estop the Service from denying an untimely refund claim, even though the delay in filing resulted from ambiguous and misleading oral statements of an IRS auditor. The court reached this conclusion on the basis that no evidence was produced to substantiate that the statements attributed to the auditor were authorized by a superior. It consequently followed the decisions of several other circuits and ruled that the general prohibition against the application of equitable estoppel involving the Service was appropriate.

Informal Settlement Agreements. A second situation in which the doctrine of equitable estoppel often arises is where the taxpayer changes his/her position after the execution of an informal settlement agreement. In this situation, the Service usually seeks to invoke the doctrine in order to estop the taxpayer from seeking a refund or credit at some later date. The question facing the courts, therefore, is whether execution of the informal settlement agreement, standing alone, prevents the taxpayer from later claiming a refund or credit.[19]

Many appellate courts, including the Second, Fifth, Sixth, and Eight Circuits, follow the general rule that when an informal settlement agreement includes in its terms an explicit preclusion of claims for refund or credit, the taxpayer is equitably bound by estoppel from subsequently seeking such claims.[20] Recently, the Third Circuit joined these other circuits with its decision for the Service in *Aronsohn.*[21] In this case, the taxpayers executed a general power of attorney authorizing their CPA to represent them before the Service. Pursuant to the appointment, the CPA handled the taxpayers' appeal of an IRS assessment and later signed an informal settlement agreement on their behalf. Before signing the agreement, however, the CPA did not receive the taxpayers' specific consent beyond the general power of attorney. One month before the statute of limitations on the assessment expired, the taxpayers filed a claim for refund contending that they were not bound by the informal settlement agreement because their CPA had not been specifically authorized to execute such an agreement on their behalf. The Service, however, sought to estop the taxpayers from seeking the refund claim because it was placed in a position where collection of previously waived penalties would be administratively impossible.

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[15] *First Alabama Bank,* 93-1 USTC ¶ 50,138, 981 F2d 1226 (CA-11), aff'g an unreported district court decision.

[16] *Louis F. Meyer,* 92-2 USTC ¶ 50,620 (DC-Ca).

[17] See *Automobile Club of Michigan,* 57-1 USTC ¶ 9593, 353 US 180 (1957); *Michael D'Amelio,* 82-1 USTC ¶ 9411, 679 F2d 313 (CA-3); *Ernst L. Posey,* 71-2 USTC ¶ 9659, 449 F2d 228 (CA-5); *Bay Sound Transportation Co.,* 69-1 USTC ¶ 9371, 410 F2d 505 (CA-5); *Leo Sanders,* 55-2 USTC ¶ 9636, 225 F2d 629 (CA-10).

[18] *Giles H. Miller,* 91-2 USTC ¶ 60,092, 949 F2d 708 (CA-4), aff'g 91-1 USTC ¶ 60,061 (DC-Va).

[19] When the Service and the taxpayer settle a disputed tax liability, a written settlement agreement generally is entered into pursuant to Section 7121. Typically, this settlement is executed as a formal closing agreement on Form 870, and the taxpayer is barred from later instituting a refund suit. In comparison, informal settlement agreements usually are executed on Form 870-AD. This form uses language similar to that of Form 870-A, but states that it does not constitute a closing agreement. As a result, informal settlement agreements, such as those executed on Form 870-AD, seem to contain contradictory language in that they purport to prevent taxpayers from reopening a disputed tax case without being settlement agreements.

[20] See *Arthur L. Stair,* 75-1 USTC ¶ 9463, 516 F2d 560 (CA-2); *F.R. Daugette,* 58-1 USTC ¶ 9156, 250 F2d 753 (CA-5, 1957); *Elbo Coals, Inc.,* 85-2 USTC ¶ 9454, 763 F2d 818 (CA-6); *J.W. Cain,* 58-1 USTC ¶ 9476, 255 F2d 193 (CA-8).

[21] *Jeff D. Aronsohn,* 93-1 USTC ¶ 50,157, 988 F2d 454 (CA-3), aff'g 92-2 USTC ¶ 50,452 (DC-Pa.).

The Third Circuit's decision in favor of the Service was based on a determination that the informal settlement agreement executed by the CPA did not require specific authorization beyond a general power of attorney. Instead, the court found that the form expressly provided for the authorized agent to perform any and all acts that the principal(s) could perform, including execution of an informal settlement agreement. Additionally, the court determined that because the informal settlement agreement included language precluding subsequent refund claims and the Service had detrimentally relied upon the taxpayers' consent in the agreement not to file such claims, the doctrine of equitable estoppel prevented the taxpayers from later seeking a refund.

Pro-taxpayer Decisions. As the preceding cases illustrate, application of the doctrine of equitable estoppel generally results in a favorable decision for the Service. Two recent examples of pro-taxpayer decisions, however, are *Howard Bank*[22] and *Combs.*[23] In *Howard Bank*, the Service audited an estate tax return and determined that additional tax was due. The estate paid the amount contended, but filed a claim for refund. The claim, however, was disallowed by the Service because other valuation issues entering into the calculation of the refund were in dispute at the time. Two years later, when the valuation issues had been settled, an IRS attorney told the administrator of the estate that the Service would reconsider its prior disallowance of the refund claim. The Service then reopened the case and, after the lapse of one year and various written correspondence, mailed a revised examination report agreeing with the amount of the claimed refund. Upon receipt, the administrator signed and returned the revised report to the Service. The Service denied the refund, nevertheless, because the statute of limitations on the original claim had expired.

In determining whether the doctrine of equitable estoppel applied, the court looked at the reasonableness of the administrator's reliance on the representations of the Service. Based on these representations, the court found that the communications of the IRS attorney were sufficient to cause the administrator to believe that the Service would rescind its earlier disallowance of the refund claim and its attendant limitation period. The court concluded, therefore, that general principles of equity required the Service to be estopped from denying the claim.

In contrast to *Howard Bank*, equitable estoppel was found not to apply in *Combs*, where the Service sought to bar the taxpayer's refund claim on the grounds that he had earlier executed an informal settlement agreement. In this case, the Service initially assessed the taxpayer a deficiency for the amount of withholding tax that it contended he owed for his employees. The taxpayer, however, disagreed with the Service's assessment because he believed the persons were independent contractors to whom withholding tax did not apply. After some negotiation, the taxpayer executed and the Service accepted an informal settlement agreement in which the taxpayer agreed to pay the assessed deficiency and not to file a subsequent claim for refund. When the taxpayer received the Service's formal assessment for the deficient withholding tax, however, he paid only a portion of the deficiency and contemporaneously filed a claim for refund of that payment. The Service subsequently denied the claim and brought suit to estop the taxpayer's actions on the basis of his earlier execution of the informal settlement agreement.

Although the court noted in *Combs* that the informal settlement agreement executed by the taxpayer included language barring subsequent refund claims, it also observed that the form contained explicit language indicating that it was not a final closing agreement. Following an earlier decision of the Seventh Circuit in *Bennett*,[24] it therefore determined that controlling law refused to allow the Service to equitably estop a taxpayer from contesting a matter not subject to formal settlement.[25] Instead, it found that the Service should have known that the agreement was not in itself binding. Additionally, it found that because a revenue procedure which provided relief to taxpayers who made informal settlements regarding withholding tax liability was in effect at the time of the agreement, any rights the Service might otherwise have had to bind taxpayers to such informal agreements were waived under the circumstances. The Service, therefore, did not have a reasonable basis from which to claim detrimental

[22] *Howard Bank*, 91-1 USTC ¶ 60,053, 759 FSupp 1073 (DC-Vt.) and 90-1 USTC ¶ 60,024 (DC-Vt.).

[23] *Eugene B. Combs*, 92-1 USTC ¶ 50,139 (DC-Ind.).

[24] *Josephine F. Bennett*, 56-1 USTC ¶ 11,600, 231 F2d 465 (CA-7), rev'g and rem'g 56-1 USTC ¶ 11,585 (DC-Ill., 1955).

[25] The court did not note that another decision of the Seventh Circuit in *General Split Corp.*, 74-2 USTC ¶ 9576, 500 F2d 998 (CA-7), held for the Service on the grounds that an informal settlement agreement prevents a taxpayer from seeking a subsequent refund claim. The decision in *General Split Corp.*, however, can be distinguished from *Bennett* (supra note 24) in that the Service relied on the informal settlement agreement to its detriment.

reliance upon the taxpayer's representation on the informal settlement agreement that he would not contest the assessment.

Equitable Tolling

Unlike the narrowly defined doctrines of equitable recoupment and estoppel, the doctrine of equitable tolling has more general application. In essence, the doctrine of equitable tolling seeks to soften the sometimes harsh effect of statutes of limitation when they operate to deny a party the opportunity to seek redress from an injury. The doctrine, therefore, differs from both equitable recoupment, which remedies inconsistently taxed items under specifically identified circumstances, and equitable estoppel, which restrains one party from assuming inconsistent positions to the detriment of another, in that it extends judicial relief to cases in which extraordinary circumstances beyond a party's control make it impossible to act within the period of time specified by the pertinent statute of limitations.

Despite the apparent broadness of the doctrine of equitable estoppel, the courts have found it to be applicable in relatively few tax cases. One primary reason for the spareness of application appears to be that the courts are reluctant to extend relief to taxpayers who simply fail to exercise due diligence in filing for a tax refund within the statutory period. A second reason for the limited application, however, appears to be a desire on the part of the courts to preserve the Congressional intent underlying the various statutes of limitations.

Judicial Relief. Because two separate judicial views exist with respect to the applicability of the doctrine of equitable tolling, some inconsistency has emerged in the decisions. For example, in *Johnsen*,[26] a district court ruled that the doctrine of equitable tolling applied to the taxpayer's refund claims, even though the statute of limitation for filing such claims had expired. In reaching its decision, the court held that mental incompetency constituted a sufficient condition to toll the statute of limitations until such time as an executor was appointed. Similar decisions were reached in *Scott*[27] and *Wiltgen*,[28] where district courts found that mental incompetency resulting from alcoholism and schizophrenia were sufficient to justify equitable tolling of the statutory filing periods.

Other decisions in *Stepka*[29] and *Oropallo*,[30] however, treated mental incompetency less sympathetically. In *Stepka*, the court did not toll the statute of limitations for the filing of a refund claim even though the taxpayer was institutionalized for mental incompetency during the statutory period. Likewise, in *Oropallo*, the First Circuit found the taxpayer's claim of incapacitation from carbon monoxide poisoning to be insufficient grounds to justify his late filing of a refund claim. The court, therefore, rejected his time-barred claim.

Strict Interpretation. Strict enforcement of the statute of limitations also occurred recently in *Vintilla*[31] and *Kishnani*.[32] In *Vintilla*, the taxpayer received a lump-sum severance payment from his former employer under controlling Venezuelan law. The former employer, however, viewed the payment as an advance of the taxpayer's retirement benefits and consequently refused to pay the taxpayer's monthly pension benefits until it had recouped the lump-sum payment by setting it off against the amount of the otherwise payable monthly pension benefits. Claiming that the former employer was wrongfully deducting amounts from his retirement benefits, the taxpayer joined 24 other former employees in filing a lawsuit to have the former employer enjoined from withholding the monthly pension benefits. This suit proceeded through the courts for more than four years before the Supreme Court denied *certiorari* and allowed the decisions of the lower courts in favor of the former employer to stand. However, prior to the filing of the suit, the Service assessed a deficiency against the taxpayer based on the fact that he had failed to report the lump-sum payment as income. This deficiency was paid by the taxpayer after an IRS agent informed him that if he lost the suit he could file for a refund. Four and one-half years after payment of the deficiency, but shortly after *certiorari* was denied, the taxpayer followed the IRS agent's advice and filed a claim for refund. The Service denied the claim, however, as being barred by the statute of limitations.

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[26] *Doris Johnsen*, 91-1 USTC ¶ 50,099, 758 FSupp 834 (DC-NY).

[27] *Nicholas T. Scott*, 92-2 USTC ¶ 50,467, 795 FSupp 1028 (DC-Haw.).

[28] *Edward P. Wiltgen*, 93-1 USTC ¶ 50,044, 813 FSupp 1387 (DC-Iowa, 1992).

[29] *Joseph Stepka*, 61-2 USTC ¶ 9559, 196 FSupp 184 (DC-NY).

[30] *Charles J. Oropallo*, No. 92-1983 (CA-1, 1993), aff'g an unreported district court decision.

[31] *Ray E. Vintilla*, 91-1 USTC ¶ 50,272, 931 F2d 1444 (CA-11), aff'g 90-2 USTC ¶ 50,353, 767 FSupp 249 (DC-Fla.).

[32] *Lilawanti Kishnani*, 93-1 USTC ¶ 50,155 (DC-NY) and 92-2 USTC ¶ 50,371 (DC-NY).

Citing *Bruno*[33] and *Republic Petroleum Corporation*,[34] the Eleventh Circuit held that even though equitable factors weighed heavily in the taxpayer's favor, it nonetheless could not allow equity to supersede the statutory requirements for the timely filing of a refund claim. Instead, the court determined that it lacked the jurisdiction necessary to toll the statutory period because Section 6511, which provides for time limitations on the filing of refund claims, does not contain an explicit extension of the period for equitable considerations.

A similar inability to toll the statute of limitations occurred in *Kishnani*, where a district court held that Congress' waiver of sovereign immunity must be construed strictly. In this case, the taxpayer, who had limited capacity with English, argued that the Service misled her into believing that no time limitation existed for the filing of a tax return claiming a refund. The court, however, interpreted the timeliness requirement of Section 6511 as a matter that was neither procedural nor remedial, but instead jurisdictional. As a consequence, it held that general principles of equity, such as equitable tolling and estoppel, could not override the statutory requirements for timely filing of refund claims.

Conclusion

Successful claims based on the doctrines of equitable recoupment, estoppel, and tolling require a complete understanding of the judicially-developed requirements of each doctrine. Such an understanding is necessary to ensure that any claims for judicial relief from the statute of limitations based on these doctrines are properly constructed and argued from the outset of a dispute, rather than simply at the time of litigation. As illustrated in this article, many recent claims based on recoupment, estoppel, or tolling have been unsuccessful because the taxpayers and their advisers failed to place their claims within the judicial context established by the courts for each of the doctrines. As a consequence, their claims were denied either for lack of jurisdiction or insufficient evidence of detrimental harm.

Proper application of the doctrines of equitable recoupment, estoppel, and tolling must originate with a claim for refund arising from some error beyond the taxpayer's control and for which the statutory mitigation provisions are inoperative. In the case of equitable recoupment, the error must relate to an inconsistency in the treatment of a single transaction occurring in different years; in the case of equitable estoppel, the error must result from an inconsistent position or representation; in the case of equitable tolling, the error must arise from extraordinary circumstances. Given such an error, the taxpayer's claim must further be founded on the exercise of due diligence within the statutory filing period. Finally, the judicial relief sought by the taxpayer must be warranted by general principles of equity. Under these circumstances, a carefully constructed argument for an equitable exception to the statute of limitations should be successful.

[33] *Frank A. Bruno*, 77-1 USTC ¶ 9124, 547 F2d 71 (CA-8, 1976), aff'g an unreported district court decision.

[34] *Republic Petroleum Corporation* 80-1 USTC ¶ 9279, 613 F2d 518 (CA-5), aff'g and rev'g 75-2 USTC ¶ 9589, 397 FSupp 900 (DC-La.).