

***Liberty Global* Turns the Deficiency Procedures Upside Down**

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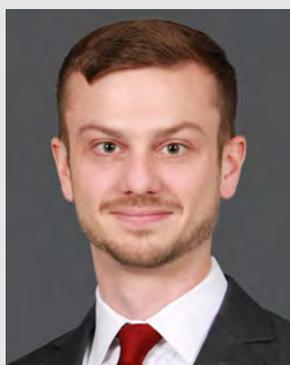
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Jenny A. Austin



Anthony D. Pastore



Jeremy D. Himmelstein

Jenny A. Austin, Anthony D. Pastore, and Jeremy D. Himmelstein are members of the tax controversy and transfer pricing practice of Mayer Brown LLP.

In this article, the authors examine the implications of a federal district court's refusal to dismiss the government's lawsuit against Liberty Global Inc. for unpaid taxes and its finding that the government has a common law right to sue for income tax deficiencies outside the administrative process.

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Can the IRS sue a corporation because it believes the company underreported its taxes? You might think the answer is no — the IRS must first propose an adjustment, let the company go to Appeals, and then issue a notice of deficiency.

Afterward, the company can either file suit in the Tax Court or pay the taxes and sue for a refund in federal district court or the Court of Federal Claims. But *Liberty Global*¹ calls into question whether that process is mandatory because a federal district court determined that the government may sue for allegedly unpaid taxes instead of issuing a notice of deficiency. All corporate taxpayers should be aware of this case.

The federal government took a surprising step in *Liberty Global* by suing the taxpayer for unpaid federal income taxes. In its motion to dismiss, Liberty Global Inc. argued that the IRC's deficiency provisions prohibit the government from suing a taxpayer without first issuing a notice of deficiency.² Not so, the court said, finding that the government can issue a notice of deficiency or exercise its "common-law right to sue for outstanding debt."³

This common law right is rarely invoked. The few cases in which it has been (aside from *Liberty Global*) generally involved the government's attempt to collect tax liabilities that had already been established or assessed. Since Congress enacted the deficiency procedures over 100 years ago, it is unclear whether the government has ever initiated a lawsuit to establish a tax deficiency rather than collect a known liability. In *Liberty Global*, it has attempted to revive this little-known common law right.

I. Legal Background

In the United States, taxpayers must file returns reporting their income and tax liability.⁴

¹ *United States v. Liberty Global Inc.*, No. 1:22-cv-02622 (D. Colo. June 1, 2023).

² Liberty Global's motion to dismiss, *Liberty Global*, No. 1:22-cv-02622 (Jan. 23, 2023).

³ *Liberty Global*, No. 1:22-cv-02622, at *5.

⁴ Sections 6011 and 6012.

The IRS may examine these returns and determine a deficiency, which is “the amount by which the tax imposed . . . exceeds . . . the amount shown as the tax by the taxpayer.”⁵ The deficiency procedures are well established in the code.⁶ Before assessing a deficiency and taking collection action, the IRS must first issue a notice of deficiency.⁷ The notice of deficiency informs the taxpayer of the alleged tax liability and instructs the taxpayer that it has 90 days to dispute the liability in the Tax Court.⁸ The IRS cannot assess or collect the tax before the taxpayer has had the opportunity to seek Tax Court review.⁹ This was not always true.

A. Brief History

Before Congress established the current deficiency procedures, the United States could generally “employ any common law remedy for the collection of its dues.”¹⁰ The government also had statutory authority to initiate “any proper form of action, before any Circuit or District Court of the United States for the district in which the liability for such tax may have been or may be incurred.”¹¹ But as the tax system evolved, the administration of the tax system evolved with it.

In 1919 Congress delegated authority to the IRS to establish administrative procedures for deficiencies, including administrative appeals of deficiency determinations.¹² In 1921 Congress enacted statutes establishing administrative appeal procedures.¹³ The Revenue Act of 1924 established the Board of Tax Appeals, the Tax Court’s predecessor.¹⁴ The Board of Tax Appeals

was the first prepayment forum in which taxpayers could challenge a deficiency determination. Congress described this as “the largest administrative benefit and relief given [to] the taxpayers” in the act.¹⁵

Congress next enacted the Revenue Act of 1926.¹⁶ Section 274(a) of this act provided text that is similar to sections 6212 and 6213. In the conference report that accompanied the bill, Congress explained that the bill prohibited the IRS from taking any “action to assess or collect by distraint or proceedings in court a deficiency in an income tax imposed by the new act until [the IRS] has mailed to the taxpayer notice of the deficiency.”¹⁷ The law would not prohibit the IRS from filing claims in a bankruptcy or receivership proceeding or from filing a counterclaim in a refund suit initiated by the taxpayer.¹⁸ However, in the legislative history, Congress indicated that the IRS could not otherwise initiate a lawsuit to collect a deficiency.¹⁹

B. The Law Today

Today the IRC provides the United States with express authorization to initiate only a handful of cases outside the deficiency process. Before initiating any civil action to collect or recover taxes or any penalties, section 7401 requires the secretary and the attorney general (or an appropriate delegate) to approve the action. Section 7402(a) provides the district courts with jurisdiction over these actions.²⁰ And sections 7403 through 7409 identify specific types of actions that the United States may bring. These include actions to (1) enforce liens and reduce assessments to judgment, (2) seek estate taxes, (3) recover erroneous refunds paid by the IRS, (4) enjoin tax return preparers, (5) enjoin tax shelter promoters, and (6) enjoin flagrant political expenditures of section 501(c)(3) organizations.

⁵Section 6211(a). The calculation also takes into account “amounts previously assessed” and “rebates” issued to the taxpayer.

⁶See generally, *Hallmark Research Collective v. Commissioner*, 159 T.C. No. 6 (2022).

⁷Section 6213(a).

⁸*Id.* Foreign taxpayers, however, have 150 days to petition the Tax Court.

⁹*Id.*; see also section 6851 (termination assessments of income tax), section 6852 (termination assessments involving 501(c)(3) organizations), and section 6861 (jeopardy assessments). These sections provide that the IRS can make immediate assessments in some extraordinary cases but that a notice of deficiency must still be issued later.

¹⁰*Dollar Savings Bank v. United States*, 86 U.S. 227, 239-240 (1873).

¹¹*Id.* at 240.

¹²Revenue Act of 1918, ch. 18, section 228.

¹³Revenue Act of 1921, ch. 136, section 250(d).

¹⁴Revenue Act of 1924, ch. 234, section 900.

¹⁵68 *Cong. Rec.* 2684 (1924).

¹⁶Revenue Act of 1926, ch. 27.

¹⁷H.R. Rep. No. 69-356 at 39 (1926).

¹⁸*Id.* See also *Lewis v. Reynolds*, 284 U.S. 281 (1932) (discussing the government’s right to claim an offset in refund litigation).

¹⁹H.R. Rep. No. 69-356 at 39 (1926).

²⁰Section 7402(b) and (e) also provide district courts with jurisdiction over summons enforcement actions and quiet title actions, respectively.

At issue in *Liberty Global* was whether the United States could sue a taxpayer for unpaid taxes without issuing a notice of deficiency. This type of suit is not addressed in sections 7403 through 7409. Section 7401 does not seem to provide the government with an open book to sue a taxpayer for unpaid taxes. Nor does this action appear to be described in the Internal Revenue Manual, the IRS's internal operating handbook.²¹ Thus the court in *Liberty Global* was faced with a question of first impression: Is a notice of deficiency a prerequisite for the government to commence a suit to establish a deficiency?

II. The Liberty Global Case

Before we get to the court's answer to this question, we need to unravel *Liberty Global's* tangled procedural history.

A. Liberty Global's Refund Suit

Liberty Global is a multinational telecommunications company. Following the 2017 Tax Cuts and Jobs Act, in December 2018 Liberty Global engaged in a transaction called "Project Soy" to take advantage of an effective date mismatch between section 951A (global intangible low-taxed income) and section 245A (deduction for foreign-source dividends). The purpose of Project Soy appears to have been to repatriate income tax free, by avoiding GILTI and subpart F, while still qualifying for the dividends received deduction. Treasury issued retroactive temporary regulations targeting Project Soy and similar transactions that closed the effective date gap in June 2019.

Liberty Global filed its 2018 federal tax return on October 11, 2019. In December 2019 it filed an amended return claiming a refund of about \$100 million in connection with Project Soy, challenging the validity of the temporary regulations. In 2020 the IRS examined the refund claim and issued information document requests concerning Project Soy. Liberty Global did not respond to the IRS's satisfaction, so the IRS issued a delinquency notice on November 19, 2020, which it typically does before serving a formal

summons, requesting a response to outstanding requests by November 27, 2020.

Liberty Global responded by filing a refund suit in the U.S. District Court for the District of Colorado on November 27, 2020.²² In the refund suit, the company argued that Treasury's section 245A temporary regulations are invalid under the Administrative Procedure Act, among other arguments. In the government's answer to the complaint, filed on March 3, 2021, it noted that because the refund suit had been filed before its examination of Liberty Global was complete, discovery on Project Soy was necessary, and it might issue a deficiency notice or bring a judicial action if it determined Liberty Global had underpaid its taxes.

Liberty Global filed a motion for summary judgment in its refund suit in October 2021, challenging the validity of the temporary regulations. In April 2022 the district court granted Liberty Global's motion for summary judgment in part.²³ Specifically, the court held that the temporary regulations are invalid, but it denied the motion to the extent that factual questions remained on Liberty Global's compliance with the underlying tax laws.

Following the court's April order, the parties filed a joint status report in July 2022 in which the government made clear its intent to pursue substance-over-form arguments, including the economic substance doctrine. Discovery on the factual questions appears to have begun in earnest in April 2022.²⁴

The statute of limitations to assess any tax for Liberty Global's 2018 tax year was going to expire on October 11, 2022. Ultimately, the taxpayer declined to extend the statute of limitations. This left the United States with a choice — to issue a notice of deficiency or to pursue a lawsuit — before the statute expired.

²² See Liberty Global's complaint, *Liberty Global v. United States*, No. 1:20-cv-03501 (D. Colo. Nov. 27, 2020).

²³ See court order granting Liberty Global partial summary judgment, *Liberty Global*, No. 1:20-cv-03501 (Apr. 4, 2022).

²⁴ See government's unopposed motion to amend schedule, *Liberty Global*, No. 1:20-cv-03501 (Jan. 5, 2023).

²¹ See IRM 5.17.4, 25.3.2, and 34.6.2.

B. The United States' Suit Against Liberty Global

On October 7, 2022, the United States filed a complaint in federal district court seeking a judgment of \$236 million in unassessed tax and \$47 million in accuracy-related penalties.²⁵ The government alleged that it had authority to seek that judgment under section 7401.²⁶

Liberty Global filed a motion to dismiss. In the motion, it contended that the issuance of a notice of deficiency is a “fundamental, statutory prerequisite for bringing a civil action for the collection of taxes.” By failing to issue a notice of deficiency, Liberty Global argued, the government could neither assess the tax nor initiate a proceeding to collect the tax.²⁷

In response, the government asserted that a notice of deficiency is required only if the IRS seeks to *assess* the tax. The United States argued that the issuance of a notice of deficiency is not required in other cases. That is so, the government stated, because the United States has a common law right to sue for “unpaid income taxes, without assessment, outside of the administrative process.” In support, the United States cited no case involving a suit brought by the government to establish a taxpayer’s deficiency. Rather, the cases generally involved suits brought by the government to collect tax liabilities that had already been established.

C. The District Court’s Opinion

On June 1 the district court agreed with the government and ruled that it was not barred in its suit against Liberty Global. There are “two avenues for the government to collect unpaid taxes: the administrative route (assessment and collection) and the common-law route (filing suit on the debt).”²⁸ The court explained that, because the complaint put Liberty Global on notice for its

alleged tax liability, a notice of deficiency would have been “duplicative” and serve “no useful purpose.”²⁹

The district court relied on three cases, none of which squarely addresses the facts in *Liberty Global*:

- *Jersey Shore Bank*³⁰ involved employment taxes owed under section 3505, which provides that some third parties can be liable for a portion of employment taxes if the employer fails to pay its share of the amount owed. The third party argued that the government could not sue because the IRS never issued a notice of the assessment under section 6303.³¹ (It was undisputed that the IRS could not issue a notice of deficiency because the case involved employment taxes, not the third party’s income tax liability.) The Supreme Court held that section 3505, unlike other code provisions, does not allow the IRS to assess the tax against the third party.³² Because the tax could not be assessed, the IRS could not possibly issue a notice of the assessment. Thus, the Court held that the government could collect “only by filing a civil suit.”³³ There was simply no other option.
- *Sarubin*³⁴ involved income taxes that a taxpayer self-reported but neglected to pay. The government elected to file a lawsuit in federal district court. It sought to reduce to judgment the assessments plus interest. The taxpayer did not dispute that the government could sue to collect the assessed tax³⁵ but argued that the government could not collect the interest because no notice under section 6303 had been issued.³⁶ The Fourth Circuit disagreed, reasoning that interest compounds daily and so a notice

²⁹ *Id.* at *9.

³⁰ *United States v. Jersey Shore State Bank*, 479 U.S. 442 (1987), *aff’g* 781 F.2d 974 (3d Cir. 1986).

³¹ *Id.* at 447.

³² *Id.*

³³ *Id.*

³⁴ *United States v. Sarubin*, 507 F.3d 811 (4th Cir. 2007).

³⁵ This is contemplated by section 6502(a) (flush language).

³⁶ *Id.* at 815.

²⁵ See government’s complaint, *Liberty Global*, No. 1:22-cv-02622 (Oct. 7, 2022).

²⁶ This provision of the code requires the government to obtain authorization before initiating suit. Ultimately, the district court did not cite this statute in its opinion.

²⁷ Liberty Global’s motion to dismiss, *supra* note 2.

²⁸ *Liberty Global*, No. 1:22-cv-02622, at *5.

showing the amount due would quickly become outdated.³⁷

- *Shelter Mutual Insurance*³⁸ involved an interpleader action brought by an insurance company against the insured taxpayer and the government to determine how to distribute insurance proceeds. The government filed a cross-claim against the taxpayer to enforce tax liens that had arisen as a result of unpaid assessments.³⁹ The government also sought to reduce other tax liabilities to judgment “through a common-law action.”⁴⁰ These liabilities had been communicated through a notice of deficiency, but they had not yet been assessed.⁴¹ The taxpayer argued that the government’s claim was precluded by section 6303. Citing *Sarubin*, the district court ruled that section 6303 is inapplicable when the government seeks to reduce established tax liabilities to judgment.⁴²

III. An Analysis of the Decision

A. Statutory Analysis: Section 6213

Section 6213 is captioned “Restrictions applicable to deficiencies; petition to Tax Court.” Section 6213(a) provides that “no assessment of a deficiency in respect of any 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, nor until the expiration of such 90-day or 150-day period, as the case may be, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final.” (Emphasis added.) The proper interpretation of this statute arguably turns on the interpretation of the pronoun “its.”

If “its” refers to the “deficiency in respect of any tax,” then with only limited exceptions, the government would be required to issue a notice of deficiency before it (1) makes an assessment, (2)

institutes a levy, or (3) initiates a proceeding in court to collect the deficiency. Under this interpretation, the government’s suit in *Liberty Global* would be contrary to the statute because the government initiated a court proceeding to collect a deficiency before a notice of deficiency was issued to the taxpayer.

On the other hand, if “its” refers to the “assessment,” then the government would be required to issue a notice of deficiency only before it (1) makes an assessment, (2) institutes a levy, or (3) initiates a proceeding in court to collect the assessment. Under this interpretation, the government’s suit would not be problematic from a statutory perspective because the government did not initiate the proceeding to collect any assessment. In other words, section 6213(a) would not prohibit a pre-assessment lawsuit to recover deficiencies because the statute’s restrictions apply to collecting assessments, not deficiencies.

It is arguably most natural to read section 6213 as placing restrictions on the government’s ability to pursue a deficiency in court.⁴³ After all, the statute is captioned “restrictions applicable to deficiencies,” not “restrictions applicable to assessments.” Beyond the text, this interpretation of section 6213(a) is supported by the legislative history of the deficiency procedures. While the government’s practice in the 1800s may have been to bring affirmative tax suits, this practice appears to have changed in the 1920s when Congress established the deficiency procedures along with the Tax Court’s predecessor, the Board of Tax Appeals. When making further revisions to the prior iteration of section 6213 in 1926, Congress explained in a conference report that, in the case of a deficiency, the IRS “can take no action to assess or collect by distraint or proceedings in court a deficiency . . . until [the IRS] has mailed to the taxpayer notice of the deficiency.”⁴⁴ In light of this history, it would be reasonable to conclude

³⁷ *Id.*

³⁸ *Shelter Mutual Insurance v. Gregory*, 555 F. Supp. 2d 922 (M.D. Tenn. 2008).

³⁹ *Id.* at 930.

⁴⁰ *Id.* at 933.

⁴¹ *Id.* at 931.

⁴² *Id.* at 933.

⁴³ It appears that the Tax Court has interpreted section 6213(a) similarly. See *Kanholz v. Commissioner*, 94 T.C. 11, 19 (1990) (“Section 6213(a) unambiguously provides that — no levy or proceeding in court for its [a deficiency’s] collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer.”) (brackets in original; emphasis added); see also *Powerstein v. Commissioner*, 99 T.C. 466, 473 (1992) (“The restrictions contained in section 6213(a) preclude respondent from attempting to assess or collect a deficiency.”) (emphasis added).

⁴⁴ H.R. Rep. No. 69-356, at 39 (1926).

that Congress sought to eliminate pre-assessment suits to recover deficiencies.

Notably, since establishing the deficiency procedures, Congress has given the government other authority to sue under the tax laws. For example, section 7403 authorizes the United States to sue to enforce a lien that arises under section 6321 when a taxpayer fails to pay a liability after notice and demand. Also, section 7404 authorizes the United States to sue to collect estate taxes allegedly owed. But Congress made this statute inapplicable when “it applies to the collection of a deficiency,” which “shall be subject to the provisions of sections 6213 and 6601.”

Given these provisions, Congress may not have intended for the government to be able to sidestep administrative procedures to pursue deficiencies. If Congress did intend to allow the United States to sue for deficiencies, it arguably would have made that intent known explicitly in a statute, as it did in sections 7403 through 7409. As the Supreme Court has recognized, “Congress intends to make major policy decisions itself.”⁴⁵ And the Court looks askance at agencies that purport to “discover in a long-extant statute an unheralded power.”⁴⁶

B. Tax Policy and Taxpayer Rights

Allowing the government to sue outside the deficiency process arguably puts at issue many fundamental taxpayer protections, including the right to seek judicial review in the Tax Court.⁴⁷ Congress described the Board of Tax Appeals, the first prepayment forum, as “the largest administrative benefit and relief given [to] the taxpayers” in the Revenue Act of 1924.⁴⁸ Taxpayers could still choose to pay the tax and seek a refund in district court or the Court of Claims, but they now had another option.

The Tax Court is an attractive venue for taxpayers because, in addition to having

jurisdiction over unpaid deficiencies, it is made up entirely of judges who are tax specialists. Under the approach adopted by the district court in *Liberty Global*, the government could strip the taxpayer of its right to choose the venue by going straight to district court before the Tax Court can obtain deficiency jurisdiction.

The government argued in *Liberty Global* that its common law right to skip the deficiency process is all the more critical when the statute of limitations under section 6501 is close to running its course. But taxpayers have a right to decline to extend the statute of limitations.⁴⁹ The statute of limitations is an important taxpayer protection. It represents “an almost indispensable element of fairness as well as of practical administration of an income tax policy.”⁵⁰ The government should not try to abrogate one taxpayer right (the right to petition the Tax Court) whenever the taxpayer exercises another right (the right to decline to extend).

If the IRS believes that it has been prejudiced by a taxpayer’s failure to cooperate during an examination, the agency is free to exercise some of the other statutory rights at its disposal. This might include issuing a designated summons under section 6503(j), which, in certain circumstances, keeps the statute of limitations open. The IRS has exercised this power in other cases.⁵¹

The government’s supposed common law right arguably infringes on other taxpayer rights beyond the right to seek prepayment review in the Tax Court. For example, under the Taxpayer First Act, taxpayers will “generally” have the right to an administrative appeal to the IRS’s Appeals function.⁵² It seems difficult to square taxpayers’ general right to access Appeals with the government’s supposed right to sue taxpayers outside the administrative process.

⁴⁵ *West Virginia v. EPA*, 142 S. Ct. 2587, 2609 (2022) (quotation marks and citation omitted).

⁴⁶ *Id.* at 2610 (quoting *Utility Air Regulatory Group v. EPA*, 573 U.S. 302, 324 (2014)).

⁴⁷ See Gerald A. Kafka and Rita A. Cavanaugh, *Litigation of Federal Civil Tax Controversies*, para. 1.01 (“One of the most crucial decisions that must be confronted when tax litigation becomes apparent is the forum in which to litigate the dispute.”).

⁴⁸ 68 *Cong. Rec.* 2684 (1924).

⁴⁹ Venerable tax treatises confirm that taxpayers are “not required to accept an extension.” Michael Saltzman and Leslie Book, *IRS Practice & Procedure*, para. 5.03[4][a].

⁵⁰ *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296, 301 (1946).

⁵¹ See *United States v. Microsoft Corp.*, 154 F. Supp. 3d 1134 (W.D. Wash. 2015).

⁵² Section 7803(e)(4).

IV. Implications

The implications of this new decision are unclear. On the one hand, the government might not pursue its common law right to sue outside exceptional cases — even if *Liberty Global* remains good law. The government might pursue the administrative process in most cases to take advantage of an arcane — albeit important — procedural concept. In court, a notice of deficiency is presumed correct, and the taxpayer bears the burden of disproving the government's position. In a refund action, the taxpayer bears the burden of proving it is entitled to a refund. If the government is the plaintiff, then it would presumably bear the burden of proving that the taxpayer owes additional tax. The government could not simply find holes in the taxpayer's arguments; it would need to build an affirmative case. The IRS might choose to accept the burden of proof in only the most extraordinary cases. And while this may seem like a distinction without a difference, it is more challenging to be the party that bears the burden of proof.

On the other hand, if *Liberty Global* is not otherwise overturned,⁵³ the government might view its ability to skirt the administrative process as yet another tool in its litigation toolkit. In that case, this recent opinion is just the thin end of the wedge: More taxpayers might find themselves in the same position as *Liberty Global*. If that happens, it would be incumbent on Congress to step in and clarify that the IRS must follow the administrative process in all cases.

Either way, corporate taxpayers should keep *Liberty Global* in mind when in a contentious audit. The government argued that *Liberty Global* was uncooperative in the audit, and that allegation seems to have helped the court get comfortable with the government short-circuiting the administrative process. Taxpayers should be aware that — as long as this opinion remains good law — the government has a trump card that it can play to take the matter out of the administrative process and into litigation immediately.

If the government does intend to invoke its right to sue again in the future, it should issue written guidance on when it will do so. Tax controversy practitioners know that, in some rare cases, the IRS will designate a case in audit for litigation, which will fast-track the dispute through the administrative process. But the IRS has issued detailed, written guidance on when it will designate a case for litigation.⁵⁴ The procedure that the government invoked in *Liberty Global* is even more precipitous because it skirts the administrative process entirely, and yet there is no written guidance on when the government might sue a taxpayer instead of first issuing a notice of deficiency. At a minimum, the government should let taxpayers know when it believes it is appropriate to pursue the common law right to sue. ■

⁵³ *Liberty Global* may seek an interlocutory appeal under 28 U.S.C. section 1292 to the Tenth Circuit.

⁵⁴ See IRM 4.10.28.