

TAX PROCEDURE: MORE ON DIVISIBLE TAXES AND THE FULL PAYMENT RULE

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Not all federal tax assessments are subject to the Tax Court's jurisdiction, which means that in some cases the taxpayer is left with a refund claim as the sole source of judicial review. Full payment of the disputed tax assessment is a jurisdictional prerequisite for a refund claim. *Flora v. United States*, 362 U.S. 145, 150-51 (1960). There is a limited exception to this requirement: If a tax is divisible, then a payment of the tax for one or more individual transactions will suffice to establish jurisdiction. See, e.g., *Psaty v. United States*, 442 F.2d 1154, 1159 (3d Cir. 1971). The trust fund recovery penalty, which is imposed under section 6672 of the Internal Revenue Code for a failure to withhold employment taxes, has long been recognized as a divisible tax.

Some recent cases have explored whether penalties assessed under former section 6707 of the Code against a tax shelter organizer for failure to register a tax shelter under former section 6111 of the Code are divisible taxes. The issue arises for a practical reason; when a tax shelter organizer is faced with a penalty in the tens of millions of dollars, the full payment rule of *Flora* can present a serious barrier to judicial review.

In November, the Federal Circuit concluded that penalties assessed based upon the [failure to register a tax shelter were not divisible](#) and affirmed the dismissal of the taxpayer's refund claim. *Diversified Grp. Inc. v. United States*, 841 F.3d 975 (Fed. Cir. 2016). Last week, a similar decision was issued by the United States District Court for the Southern District of New York. *Larson v. United States*, No. 16-cv-00245 (VEC), 2016 U.S. Dist. LEXIS 179314 (S.D.N.Y. Dec. 28, 2016), reflecting what appears to be an emerging consensus on this issue.

Larson received a notice from the IRS in February 2011 indicating that he failed to register two tax shelters; one known as FLIP or OPIS, and a second known as BLIPS. *Larson*, 2016 U.S. Dist. LEXIS 179314 at *2. In August 2011, the IRS assessed Larson with \$160,232,026 in penalties associated with the two shelters. *Id.* at *3. In December 2012, IRS Appeals reduced that assessment to \$67,661,349 due to amounts collected from others. *Id.* In February 2015, Larson filed a refund claim and paid \$1,432,735 of the penalty. *Id.* at *4.

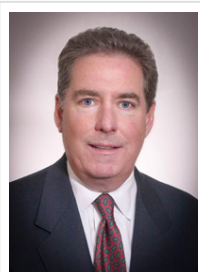
After the IRS rejected his refund claim, Larson filed a refund action, and the government moved to dismiss for lack of subject matter jurisdiction because he did not pay the full amount of the assessment. *Id.* at *4-*5. The district court sustained the government's position, noting that two prior opinions had held that penalties imposed under former section 6707 for failure to register a tax shelter were not divisible. *Id.* at *9 (citing *Diversified Group*, 2016 U.S. App. LEXIS at *18-*19; *Pfaff v. United States*, 2013 U.S. Dist. LEXIS 30844, *10 (D. Colo. Mar. 10, 2016)). In the *Larson* Court's view, these courts had correctly held that the penalty was not a divisible tax because it was "triggered by a single event," which was the failure to register the shelter. *Id.* at *9-*10 (citations omitted). The court distinguished the section 6707 penalty from the trust fund recovery penalty, noting that trust fund recovery penalty assessments "represent an accumulation of separate assessments for each employee from whom taxes were not properly withheld; *each failure to withhold is a separate punishable offense.*" *Id.* at *11 (emphasis supplied; citations omitted).

Mr. Larson also sought to argue that application of the full payment rule in his circumstances would result in a due process violation. The district court rejected that argument out of hand, treating it as an argument that the full payment rule should not apply whenever Tax Court review was unavailable, a result that would be fundamentally inconsistent with the Supreme Court's holding in *Flora*. *Id.* at *12-*13. In the court's view, this was merely a request for a hardship exception to the full payment requirement, which many courts had rejected in the past. *Id.* at *13-*14.

While the argument that the section 6707 penalty is a divisible tax is intriguing, on balance the fact that it is imposed based upon a single violation suggests that this penalty is not divisible, as the Federal Circuit previously had held. Consequently, the *Larson* court's conclusion that the penalty was not divisible appears sound.

In contrast, the court appears to have given Larson's due process argument short shrift. Mr. Larson was not merely arguing that the amount of the penalty created a hardship; he was arguing that it was incorrectly calculated. *Id.* at *9 n. 6. In *Phillips v. Commissioner*, 283 U.S. 589 (1931), the Supreme Court held that under the Fifth Amendment, tax liabilities could be imposed without a prior judicial determination, "if the opportunity given for the ultimate judicial determination of the liability is adequate." *Id.* at 597 (citations omitted).

Given that background, it seems plausible that stringent enforcement of the full payment rule could violate the due process clause if a taxpayer faces a very large assessment that rests on a questionable basis. The truism that the full payment rule necessarily imposes a hardship on taxpayers could certainly be reconciled with the idea that the due process clause may impose some limitations on its application in a particular case. Perhaps further consideration of Mr. Larson's due process argument would not have made a difference in the outcome, but a more developed analysis appears to have been warranted.



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