Seventh Circuit Rejects Tax Court's Grant of Post-Trial Motion to Vacate Decision as Circumvention of Expired Statute of Limitations for Assessment

By Philip D. Speicher

Philip D. Speicher examines the Seventh Circuit decision in *S.W. Enterprises.*

Introduction

The Seventh Circuit recently reaffirmed that the U.S. Tax Court's authority to vacate a final decision is subject to strict limitations. Specifically, the Tax Court's authority to vacate a final decision does not extend to circumstances involving the mere correction of a clerical error in the decision. In *S.W. Enterprises,*[1] the issue before the Court of Appeals was whether the Tax Court had authority to correct a clerical error in its decision after the decision had become final and nonappealable. However, the true impact of this ruling is its rebuke of the IRS's attempt in a post-trial procedural maneuver to circumvent the statute of limitations for assessment of tax.

Background

Seven W. Enterprises appealed to the Seventh Circuit from a decision for the IRS following a 2009 trial before the U.S. Tax Court. The trial involved a dispute over tax deficiencies proposed by the IRS against two corporate taxpayers, Highland Supply Corporation ("Highland") and Seven W. Enterprises, Inc. ("Seven W"), in a consolidated case.

Highland is a fiscal year taxpayer, while Seven W files its return on a calendar year basis. The proposed deficiencies were for Highland's 2003 and 2004 fiscal years and Seven W's 2000 through 2003 calendar years. Because the proposed deficiencies were based on the same underlying legal issue, the two Taxpayers' cases were consolidated for trial.

Following the 2009 trial, the Tax Court issued an opinion in 2011 upholding some of the proposed deficiencies.[2] The day after issuing its opinion, the Tax Court entered decisions in each of the cases. Although the opinion recited the correct tax periods and deficiencies, the decisions inadvertently attributed Highland's deficiencies to Seven W and *vice versa*. The decisions became final 90 days later. The IRS failed to take note of the clerical error and mistakenly assessed Highland's deficiencies against Seven W and Seven W's deficiencies against Highland. The statute of limitations for assessment expired shortly thereafter, and the IRS's assessment error was not discovered until after the limitations period had expired.

The IRS first discovered the error in the decisions and the assessments in December 2011. The impact of the IRS's error was immediately apparent. Under Code Sec. 6501, the statute of limitations for assess-

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ment is tied directly to the entry date of the Tax Court's decision. The limitations period generally expires 60 days[3] after a decision becomes final,[4] which occurs when the 90-day appeal deadline expires.[5] In this case, the error was discovered more than 60 days after the decisions had become final.

Because the statute of limitations for assessment had expired, the IRS realized it could not correct the erroneous assessments unless the entry dates of the decisions were vacated and replaced by new decision documents. Accordingly, the IRS filed a motion asking the Tax Court to vacate the original decisions due to the clerical error and to enter new decisions reciting the correct tax years and tax amounts. The IRS apparently assumed that it would get a second chance at assessing the deficiencies if the Tax Court reset the 60-day clock by entering new decisions. Over the Taxpayers' objection, the Tax Court granted the IRS's motion to vacate, and the Taxpayers appealed.

> However, the true impact of this ruling is its rebuke of the IRS's attempt in a post-trial procedural maneuver to circumvent the statute of limitations for assessment of tax.

Vacatur vs. Rule 60(a)

In the proceedings before both the Tax Court and the Seventh Circuit, the Taxpayers and the IRS presented two competing methods for correcting the error in the decisions. The IRS advocated for vacatur in an attempt to resurrect the statute of limitations by gaining entry of replacement decisions with new dates. The Taxpayers argued that the Tax Court lacked jurisdictional authority to grant the IRS's request for vacatur of a final decision. The Taxpayers instead proposed that the decisions be corrected under the procedure provided in Rule 60(a) of the Federal Rules of Civil Procedure.

Rule 60(a) states, "The court may correct a clerical mistake … whenever one is found in a judgment, order, or other part of the record." The Taxpayers took the position that the Tax Court had authority to enter a Rule 60(a) corrective order in this case, which would accomplish the purpose of correcting the court's record without altering or otherwise affecting the finality of the original decisions.

The Taxpayers relied on two lines of precedent to support their position. First, the Seventh Circuit previously held in *Drobny*[6] that the Tax Court is a court of limited jurisdiction and does not have authority to vacate a decision once it has become final unless there has been fraud on the court. Second, the Seventh Circuit had previously considered a similar situation in *Michaels*.[7] In *Michaels*, the Tax Court entered a decision that recited an incorrect tax year, but the IRS discovered the error and assessed the tax for the correct tax year. The IRS subsequently filed a motion asking the Tax Court to vacate the original decision and enter a new, corrected decision. The Tax Court denied the IRS's motion to vacate but entered a corrective order under Rule 60(a), and the Seventh Circuit affirmed.[8] However, when presented with the very same motion under similar circumstances in *S.W. Enterprises,* the Tax Court granted the motion and declined to invoke the corrective procedure in Rule 60(a).

In *S.W. Enterprises*, after evaluating the arguments advanced by the IRS and the Taxpayers, the Seventh Circuit agreed with the Taxpayers and reversed the Tax Court's grant of the motion to vacate. The Seventh Circuit first observed that there was no evidence or allegation of fraud on the court in this case and reaffirmed the rule that the Tax Court does not have authority to vacate a final decision in the absence of fraud on the court. The court then held that its prior ruling in *Michaels* was controlling and that the Tax Court should have denied the IRS's motion to vacate and simply corrected the original decisions as permitted under Rule 60(a).

Statute of Limitations

Although the Seventh Circuit's ruling in *S.W. Enterprises* is not a landmark decision on the issue of the Tax Court's authority to grant a motion to vacate, the true significance of the ruling is its effect on the IRS's attempt to create a loophole in the statute of limitations. By requesting vacatur, the IRS sought to revive and extend the statute of limitations for assessment beyond the original expiration date. Although it acknowledged that a Rule 60(a) corrective order was a viable remedy, the IRS nevertheless opposed that remedy simply because it would not accomplish the underlying goal of reopening the statute of limitations. The Seventh Circuit's opinion in *S.W. Enterprises* resolves any doubt regarding the Respondent's attempt to use a post-trial procedural motion to bootstrap an assessment otherwise barred by the statute of limitations. It draws a procedural bright line by ruling that the authority of the Tax Court to vacate its decision to correct a clerical mistake is limited to the period before the decision becomes final.

Because the statute of limitations for assessment is tied to the entry date of the decisions, the limitations period for assessing the tax will be based on the entry date of the original decisions. While it is little consolation to the IRS, a motion by Respondent to correct the clerical mistake under Rule 60(a) may be made at any time to correct the record. However, such motion cannot affect the substantive rights of the Taxpayer after the statute of limitations bar date.

Consistent with the precedent set in *Michaels*, the Seventh Circuit confirmed in *S.W. Enterprises* that, absent a showing of fraud upon the court, the IRS cannot use a minor clerical error in a decision to manipulate the statute of limitations. The Seventh Circuit's ruling preserves the integrity of the statute of limitations for assessment by preventing the IRS from using a post-trial procedural maneuver to vacate a decision more than 60 days after it has become final and nonappealable.

Endnotes

1 *Seven W. Enterprises, Inc. & Subsidiaries*, CA-7, 2013-2 USTC ¶50,443, 723 F3d 857.
2 *Id.*, at 136 TC 539, Dec. 58,650 (2011).
3 *See* Code Sec. 6503(a)(1).
4 Code Sec. 7481.
5 Code Sec. 7483.
6 *S. Drobny*, CA-7, 97-1 USTC ¶50,401, 113 F3d 670.
7 *J.M. Michaels*, CA-7, 98-1 USTC ¶50,425, 144 F3d 495.
8 *Id.*, at 496.