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East Bay Estate Planning Council

TAXPAYER EQUITY

IRC SECTION 6511(h): FINANCIAL DISABILITY; FIVE CASE STUDIES OF USE

Internal Revenue Code Section 6511 Limitations on credit or refund explicitly allows a suspension of limitations while the "taxpayer is unable to manage financial affairs due to disability", under Section 6511(h). A similar provision exists as well in CA RTC Section 19316, enacted in 2000, subsequent to an unpublished opinion by the State Board of Equalization for *The Estate of Jennie Pappas*, brought by Lisa Powers on behalf of the client/decedent.

To qualify, the specific requirement for both the federal and state statutes is:
"if such individual is unable to manage his financial affairs by reason of a medically determinable physical or mental impairment of the individual which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months".

The full requirements, per IRS Revenue Procedure 1999-21 are fairly rigorous:

- A certified letter stating to the type or nature of the impairment by the taxpayer's M.D. and the duration it has or will be expected to continue must be provided to IRS or FTB to achieve the finding by either tax agency, and
- the taxpayer must also sign a certified statement saying there was no other person capable or charged with helping the taxpayer manage their financial affairs (such as a spouse, child, trustee, etc)

Cases where our firm has used this provision are:

1). Estate Decedent for 9 years prior to death; Age 82:
Taxpayer decedent had been semi-conscious for 9 years preceding her death. In addition: the taxpayer's CPA had had Alzheimer's disease for more than 5 years and had not filed annual tax returns. FTB levied taxpayer for $152,000 in Year 6. The FTB statute of limitations made it impossible for taxpayer's estate to successfully claim a refund for the incorrect levy. By winning

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on appeal to the State of CA Board of Equalization, taxpayer's estate was refunded both the levied amount, which had never been due, and statutory interest for appr. 10 years.

<u>2). Swindled widow with two expensive civil litigation cases; Age 72</u>:

Client was found to be financially disabled for federal tax purposes, and thus able to make a late-filed election to carryback a 1998 net operating loss to the three preceding tax years and receive cash tax refunds and interest of $563,000, which helped to recoup her out of pocket (even larger) legal fees paid during the litigation. The cases' large litigation fees of $1.2 million were also deducted as ordinary losses, along with other claims in amended returns filed for the three open tax years, which generated the carryback refunds. (Note: California did not then allow NOL carrybacks, so the 1998 CA NOL was allowed to be carried forward for up to 20 years.)

<u>3). Start-up stock programmer during a six-year (recurring condition) clinical depression; Age 36</u>

Client had failed to file tax returns for 8 years. During the depression period, he exercised employee stock options to provide for his living expenses, and failed to notice (amongst other things) that his former wife and also FTB were taking funds out of his bank account amounting to $1.1 million over two years. The FTB levies and garnishments alone were nearly $600,000. The former spousal theft loss was $528,000, and was allowed by IRS as an ordinary loss deduction by IRS Appeals for 2005 and 2006. Also allowed on amended returns for the six-year period of depression were ordinary losses of $1.2 million for taxpayer's operation and loss in foreclosure of a bona-fide thoroughbred horse-breeding farm. A finding of financial disability was granted by IRS by IRS Appeals in a hearing for the spousal theft loss years.

The Federal finding of "financial disability" during this period was key in the allowance of a subsequent finding, with FTB. FTB refunded taxpayer $932,000 of levied tax and interest, after offset for other years' tax and interest owed. The IRS amount originally due of $1.6 million was reduced to appr. $175,000 net tax and interest due, which had already been fully paid by the taxpayer for the years' concerned.

4). <u>Financially challenged taxpayer with Stage 4 duodenal cancer; Age 62:</u>

A gentleman who endured four surgeries and numerous chemotherapy series, used IRC 6511(h) to abandon an originally filed election by he and his wife's filing as "married filing separately" for the 2009 year, to convert to "married filing jointly". Doing so allowed deduction of the husband and wife's business expenses in a 2009 amended return which had been overlooked in the original return, yielding appr. $67,000 in federal and state tax refunds. This was a pro-bono case for our firm.

5). Professional athlete with mental cognition difficulty coerced to invest in bogus tax shelters; Age 40:

While still playing, the athlete was coerced to invest in a bogus and other investment scheme(s), due to declining mental acuity. The amount of money involved was significant, as were the bogus deductions originally claimed … and the ultimate IRS reversals, all told. Financial disability as a factor was used to deter and halt IRS collection of large amounts of money and property of the financially damaged client. This finding also allowed time to file amended income tax returns to claim fraud and worthless investment assets' deductions to replace the former bogus tax shelter deductions claimed in the originally filed returns. The years' cases are still pending, although some of them have been allowed and closed.