Statute of Limitations for Bona Fide Residents of Puerto Rico

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Over the past 12 years, during seminars, speaking engagements, and in prospective client meetings regarding Puerto Rico's Act 60 program, a question that we receive quite often is: *"How long do I need to be concerned about the IRS examining my US tax return?"* Since it is such a popular topic, it is going to be the subject of this article. The answer, as with most issues, is multi-pronged and fact specific. As a reminder, we are not attorneys and nothing in this article can be construed as legal advice. This is an important disclaimer because the answer to this question often requires an analysis of both civil and criminal rules. This article discusses those time limits and introduces some issues that the reader may want to discuss with their legal counsel.

Importance of Statutes of Limitations

In *Rothensies v. Electric Storage Battery Co.*,[1] the Supreme Court stressed the importance of a statute of limitations, stating:

> It * * * would be all but intolerable * * * to have an income tax system under which there never would come a day of final settlement and which required both the taxpayer and the Government to stand ready forever and a day to produce vouchers, prove events, establish values and recall details of all that goes into an income tax contest. Hence, a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy.
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> * * * Statutes of limitation * * * are designed to promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared. The theory is that even if one has a just claim it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute them. [Internal quotations omitted]

[1] 329 U.S. 296, 301 (1946).

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Statute of Limitations

A statute of limitations is the time period established by law during which the government can review, analyze, and resolve tax-related issues. When the statutory period expires, the IRS can no longer assess or collect additional tax, or allow taxpayers to claim a refund.[2]

General Rules (3 Years or No Limit)

In general, the assessment of a deficiency in tax must be made within 3 years of the taxpayer's filing of his or her return.[3] However, there is no limit on the time to assess tax if the IRS proves fraud[4] or if the taxpayer does not file a return.[5] If a taxpayer files a late return, the statute of limitations ends 3 years after the filing of the late return.[6]

The limitations period is extended to 6 years in three circumstances discussed below.

Substantial Omission of Gross Income (6 Years)

The limitations period is extended to 6 years when a taxpayer omits from gross income an amount that exceeds 25% of the gross income required to be shown on the taxpayer's return.[7] However, an amount is not considered omitted from gross income if the amount is "disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the [IRS] of the nature and amount of such item."[8]

2 Code §6501, et. seq. All section references are to the Internal Revenue Code of 1986, as amended (the "Code") and the regulations promulgated thereunder.

3 Code §6501(a).

4 Code §6501(c)(1) and (2).

5 Code §6501(c)(3).

6 Code §6501(a).

7 Code §6501(e)(1)(A)(i).

8 Code §6501(e)(1)(B)(iii).

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This 25% omission from gross income rule is particularly relevant to bona fide residents of Puerto Rico because is it normal for bona fide residents of Puerto Rico to exclude Puerto Rican-source income from their US tax returns.[9]

> Example 1: Tony is a bona fide resident of Puerto Rico. Tony's worldwide gross income is $40,000,000, with $30,000,000 being Puerto Rican-source income and $10,000,000 being US-source income. The $30,000,000 of Puerto Rican-source income can be excluded from Tony's US tax return.[10] Therefore, Tony's US tax return is only required to show $10,000,000 of gross income.
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> If it is later determined that $12,000,000 of the $30,000,000 is more properly characterized as US-source income, Tony will have excluded 54.5% ($12,000,000 /$22,000,000) of the gross income required to be shown on his return, and the statute of limitations will be extended to 6 years. That is, unless Tony disclosed in his return, or in a statement attached to his return, the nature and amount of the $12,000,000. If Tony had attached such a statement, the $12,000,000 would likely not be considered omitted from his gross income, and the 6-year statute of limitations would likely not apply.

To avoid the potential 6-year statute of limitations, bona fide residents of Puerto Rico should be sure to disclose on their US tax returns the nature and amount of any income that will be excluded from US gross income.[11]

Omission of Income from Foreign Financial Assets (6 Years)

IRS Form 8938, *Statement of Foreign Financial Assets*, requires certain taxpayers to disclose information about foreign financial assets.[12] If a taxpayer improperly omits more than $5,000

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9 Code §933(1).

10 *Id.*

11 In *Colony, Inc. v. Commr*, 357 U.S. 28, 36 (1958), the Supreme Court construed the term "omit" in the predecessor of Code §6501(e)(1)(A) as applicable where the return contains "no clue to the existence of the omitted item." In determining whether adequate disclosure has been made under Code §6501(e)(1)(A)(ii), the Tax Court has similarly looked to see whether the return offered a "clue" as to the existence, nature, and amount of omitted income. *Quick Trust v. Commr.*, 54 T.C. 1336 (1970).

12 Code §6038D and Treas. Reg. §1.6038D-1 through 8. Financial assets in Puerto

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from gross income, where the omitted amount is attributable to foreign financial assets, the limitations period on assessment is extended to 6 years.[13] This rule applies regardless of whether or not the taxpayer is required to file Form 8938.[14]

Omission of Subpart F Income or GILTI Inclusions (6 Years)

US shareholders[15] of controlled foreign corporations ("CFCs")[16] are often required to include Subpart F Income and/or global intangible low-taxed income ("GILTI") inclusions in their gross income.[17] If such a US shareholder omits from his or her gross income Subpart F Income or GILTI inclusions that are required to be shown on his or her return, the limitations period on assessment is extended to 6 years.[18]

Failure to Include International Disclosure Forms (Until 3 Years After the Forms Are Filed)

An important rule for bona fide residents of Puerto Rico relates to an extension of the statute of limitations for failure to file certain international disclosure forms.[19] Bona fide residents of Puerto Rico often miss filing certain of these forms, which can keep the statute of limitations open indefinitely.

The international disclosure forms captured by this rule include:

1. Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*,
2. Form 8621, *Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*,

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Rico generally do not need to be reported on Form 8938 for bona fide residents of Puerto Rico. Treas. Reg. §1.6038D-7(c).

13 Code §6501(e)(1)(A)(ii).

14 Code §6501(e)(1)(A)(ii), parenthetical.

15 Code §951(b).

16 Code §957(a).

17 Code §§951(a) and 951A.

18 Code §6501(e)(1)(C).

19 Code §6501(c)(8).

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3. Form 926, *Return by a U.S. Transferor of Property to a Foreign Corporation*,
4. Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*,
5. Form 8938, *Statement of Foreign Financial Assets*,
6. Form 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, and
7. Form 3520-A, *Annual Information Return of Foreign Trust With a U.S. Owner*.

Bona fide residents of Puerto Rico often do not realize that they may need to file Form 926.

> Example 2: Grace is a US citizen who became a bona fide resident of Puerto Rico in 2021. In 2021, Grace formed an Act 60 company ("PRCo") in Puerto Rico. PRCo is wholly-owned by Grace, and it is classified as a corporation for US tax purposes. As part of the 2021 formation of PRCo, Grace contributed $100 as equity into PRCo. However, Grace was not advised that she needed to file Form 926 with respect to the transfer of the $100 to PRCo.[20] The statute of limitations for Grace's 2021 tax return will remain open until 3 years after she files Form 926. If she never files Form 926 for 2021, then the statute of limitations for that year will remain open forever.
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> Grace's failure to file Form 926 for 2021 does not only extend the assessment period with respect to PRCo or Form 926. Instead, the extended period applies to her entire tax return for 2021.[21] See our article that discusses the Form 926 filing requirements for residents of Puerto Rico.

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[20] Code §6038B, Treas. Reg. §§1.6038B-1 and 1.6038B-1T. There are no special exceptions to filing Form 926 for bona fide residents of Puerto Rico.

[21] CCA 201206014 ("The HIRE Act amendment to section 6501(c)(8) * * * clarifies that a failure to file [certain information returns] for a particular tax year extends the time for the assessment of tax with respect to any tax return to which the information relates." [Emphasis in original]), CCA 201147030, and AM 2014-002.

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Complicated rules apply to determine whether Forms 5471 are required for Puerto Rican entities owned by bona fide residents of Puerto Rico. If one or more Forms 5471 are missed for a particular year, the statute of limitations for that year will remain open until 3 years after the Forms 5471 are filed.

> Example 3: In 2024, Joe is a bona fide resident of Puerto Rico. Joe owns 100% of USCo, a US C corporation and 100% of PRCo, a Puerto Rican limited liability company that is classified as a corporation for US tax purposes. In 2024, USCo paid a management fee of $10 million to PRCo. The primary justification for the amount of the management fee is the expertise provided by Joe (through PRCo).
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> In 2024 (and for the past few years), Joe spent 40% of his time in the US. During his time in the US, Joe performed his normal duties on behalf of PRCo. Accordingly, up to 40% of PRCo's gross income is US-source income and is effectively connected with the conduct of a trade or business in the US.[22] For multiple reasons, Joe is required to file Form 5471. First, PRCo is a controlled foreign corporation ("CFC"), and Joe is a US shareholder with respect to the CFC.[23] US shareholders that control CFCs must file Form 5471 as Category 4 and 5 filers.[24] Second, PRCo will not meet the 80% test in Treas. Reg. §1.937-2(g)(1)(ii)(A), meaning that Joe will be considered a US person who controls PRCo.[25]
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> If Joe fails to file Form 5471 for 2024, the statute of limitations will remain open until 3 years after he files the form.

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22 The management fee received by PRCo is for services performed, and services performed in the US are US-source income. Code §861(a)(3) and Treas. Reg. §1.861-4. The term trade or business within the US includes the performance of personal services in the US. Code §864(b).

23 Puerto Rican corporations avoid CFC status when they are owned by bona fide residents of Puerto Rico where dividends paid by the corporation are wholly Puerto Rican-source income. Code §957(c)(1). Here, a portion of PRCo's dividends will not be Puerto Rican-source income. Code §861(a)(2)(B). Therefore, PRCo cannot avoid CFC status.

24 Code §6038(a)(1), Treas. Reg. §1.6038-2, and Code §6038(a)(4).

25 Treas. Reg. §1.6038-2(d)(2)(i).

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Certain aspects of the passive foreign investment company ("PFIC") rules do not apply to bona fide residents of Puerto Rico.[26] However, there are no exceptions to the annual filing requirements with respect to PFICs[27] for bona fide residents of Puerto Rico. Therefore, Form 8621 may be required for a bona fide resident of Puerto Rico even if no US tax is due with respect to the PFIC.

> <u>Example 4</u>: In 2023, Kevin is a bona fide resident of Puerto Rico. Kevin owns 100% of PRCo, a Puerto Rican limited liability company that is classified as a corporation for US tax purposes. PRCo owns Kevin's principal residence in Puerto Rico that was purchased several years ago for $5 million. Although PRCo is not a CFC, Kevin was advised that he needed to annually file Form 5471 for PRCo.[28] Therefore, Kevin timely filed Form 5471 for PRCo in 2023. However, Kevin's US tax advisor did not realize that his residence held by PRCo is a passive asset because it is an asset that does not give rise to any income.[29] Because more than 50% of PRCo's assets are passive assets, PRCo is considered a PFIC. Kevin is required to annually file Form 8621 for PRCo.[30] Kevin was unaware of this requirement, and he did not file Form 8621 for 2023.
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> The statute of limitations for Kevin's 2023 tax return will remain open until 3 years after he files Form 8621. If he never files a 2023 Form 8621, then the statute of limitations for that year will remain open forever. Similar to Grace above, the extended period applies to Kevin's entire tax return and is not limited to adjustments related to PRCo.

In many cases, the failure to file a form or a return is an inadvertent oversight or the result of poor planning. However, if the IRS suspects fraud has occurred with respect to a taxpayer, a different set of rules applies. If the IRS alleges civil fraud, the statute of limitations on assessments and civil penalties will never begin and therefore never expire. Additional issues arise if the taxpayer is referred to the IRS Criminal Investigation division in connection with that suspected fraud.

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26 Prop. Treas. Reg. §1.1291-1(f).

27 Code §1298(f) and Treas. Reg. §1.1298-1.

28 Treas. Reg. §1.6038-2(d)(2).

29 Code §§1297(a)(2), (b)(1) and 954(c)(1)(B)(iii).

30 Code §1298(f) and Treas. Reg. §1.1298-1. Certain exceptions to the annual filing requirement may be available, but those exceptions are not discussed here.

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Criminal Offenses

What begins as a civil audit can escalate into a criminal investigation if the IRS auditor uncovers "firm indications of fraud".[31] In such instances, the case is referred to the IRS Criminal Investigation division ("IRS CI") which employs special agents to investigate potential criminal violations of the Internal Revenue Code.[32] The IRS Manual provides notable commentary and instruction on the issues. Specifically, it provides:

> Avoidance of taxes is not a criminal offense. Any attempt to reduce, avoid, minimize, or alleviate taxes by legitimate means is permissible. The distinction between avoidance and evasion is fine, yet definite. One who avoids tax does not conceal or misrepresent. He/she shapes events to reduce or eliminate tax liability and, upon the happening of the events, makes a complete disclosure. Evasion, on the other hand, involves deceit, subterfuge, camouflage, concealment, some attempt to color or obscure events or to make things seem other than they are. For example, the creation of a bona fide partnership to reduce the tax liability of a business by dividing the income among several individual partners is tax avoidance. However, the facts of a particular investigation may show that an alleged partnership was not, in fact, established and that one or more of the alleged partners secretly returned his/her share of the profits to the real owner of the business, who, in turn, did not report this income. This would be an instance of attempted evasion.[33]

Separate statutes of limitations apply to federal tax crimes. The IRS Manual describes the statutes of limitations applicable to various types of potential federal tax crimes, as follows:

1. Code §6531 provides a three-year statute of limitations for most criminal offenses arising under the internal revenue laws.
2. However, a six-year limitations period applies to the following offenses, which are described or specifically enumerated in Code §6531:
    a. Code §7201 (evasion of tax or payment)
    b. Code §7202 (failure to collect, account for or pay over tax)

31 IRS Manual 25.1.2.2 (04-23-2021).

32 https://www.irs.gov/compliance/criminal-investigation/how-criminal-investigations-are-initiated

33 IRS Manual 9.1.3.3.2.1 (05-15-2008).

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c. Part of Code §7203 (failure to pay tax; failure to file certain returns)

d. Code §7206(1) (filing false return)

e. Code §7206(2) (aiding or assisting in preparation of false return)

f. Code §7207 (delivering or disclosing false document)

g. Code §7212(a) (attempting to interfere with the administration of the internal revenue laws)

h. 18 U.S.C. §371 (conspiracy to commit tax evasion; conspiracy to defraud the internal revenue service).[34]

If IRS CI does receive a referral, it would stand to reason that the applicable statute of limitations is a critical, if not watershed, component for IRS CI to consider when investigating potential tax crimes. The IRS Manual contains a comprehensive overview of the applicable statutes of limitations as it relates to tax offenses and even provides examples, as follows:

> Generally, the statute of limitations begins to run on the day the offense is completed. For example, if a false income tax return were filed on April 20, 2021, the statute of limitations would begin to run on April 20, 2021, and, provided there were no circumstances to toll the statute, it would expire on April 20, 2027. Once the statute of limitations expired, prosecution would be barred.
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> The specific elements of the offense at issue must be examined to determine when the offense is completed. As illustrated below, different events "complete" different offenses:
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> a. Filing a false return: In general, the offense is complete on the day the return is filed. However, if the return is filed early, the offense is complete on the statutory due date, which is provided by 26 USC 6072 (but see below). If the return is filed late, the offense is complete on the day the return is received by the IRS Campus. If an extension of time to file has been granted, the offense is complete when the return is filed, regardless of whether it is filed before or after the extension date.

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34 IRS Manual 9.1.3.6.1 (05-15-2008). Code §7608 authorizes CI special agents to investigate and enforce the criminal provisions of the internal revenue laws and other laws for which the Secretary of the Treasury has delegated investigative authority to the IRS.

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b. Failure to file a tax return: The offense is complete on the date the return is due. If a defendant has obtained an extension of time to file a tax return, there is no duty to file until the extension date. The extension date applies only if the extension is valid (see 26 USC 6081 and the regulations thereunder for the required procedures). An extension of time to file does not extend the time for payment of tax due on the return. Therefore, a request for an extension is only valid when accompanied by payment of the taxpayer's estimated tax liability.

c. Tax evasion: The general rule is that the offense is complete on the date the last affirmative act took place or the statutory due date of the return, whichever is later. For example, the affirmative act of evasion may be a false statement made to collection agents after the return is filed. In such a case, the offense would be complete at the time the false statement was made.

d. Conspiracy: The offense is complete on the date of the last overt act proved. This last overt act may be performed by any member of the conspiracy and must be in furtherance of the object of the conspiracy.[35]

According to the IRS Manual, IRS CI and the Department of Justice Tax Division ("DOJ") will examine the facts and circumstances of the taxpayer's situation and determine the appropriate statute of limitations period.

<u>Suspension of the Statute of Limitations</u>

Based on the analysis above, most taxpayers would generally breathe a huge sigh of relief when they arrive at the end of the 6-year period. Assuming the IRS has not alleged any indication of fraud, tax practitioners have historically relied upon the 6-year period to mark the end of potential audit activity and liability. However, more than once in the past few years, we have heard discussion about the rarely used Wartime Suspension of Limitations Act that can effectively extend the statute of limitations indefinitely for tax offenses. While we generally limit our commentary to civil tax issues, and do not provide any legal advice or analysis, it is worth including a brief discussion of a potential tool that the DOJ might attempt to utilize against unsuspecting taxpayers in order to extend the 6-year statute of limitations period.

35 IRS Manual 9.1.3.6.3 (02-24-2010).

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As usual, we will use an example to help illustrate the point, as we understand it. Please note we are not attorneys and cannot provide legal advice. The following is solely for discussion purposes and to highlight an issue that may be of interest to taxpayers and their legal advisors.

Example:

Theo and Marlene moved to Puerto Rico in 2013. They traveled back and forth to the US quite a bit in 2014 to attend parties, vacation, and celebrate the sale of Theo's company with family and friends. Soon thereafter, they discovered they did not meet the presence test to qualify as residents of Puerto Rico in 2014. [36] After discussing the tax implications and realizing how much additional tax liability they would potentially incur, Theo and Marlene decided to falsify their travel docs and calendar entries to make it look like they were in Puerto Rico more than 183 days. They tell their tax preparer that they spent 185 days in Puerto Rico in order to pass the presence test. They file their 2014 US tax return on October 15, 2015 and exclude a significant amount of PR-source income from their US tax return.

In 2020, they moved back to South Florida to be closer to their aging parents. On October 15, 2021, Theo and Marlene enjoy a celebratory dinner to commemorate the end of the 6-year statute of limitations period for their 2014 federal tax return. They were never contacted or audited by the IRS criminal or civil division and feel a tremendous relief that any future inquiry of the 2014 return would be prohibited due to the expiration of the statute of limitation period.

On May 1, 2023, the IRS opens a civil audit on Theo and Marlene's 2020 federal tax return which was filed on Oct 15, 2021. Due to some irregularities in connection with their claimed business deductions, IRS civil refers the exam to IRS CI. On March 17, 2025, IRS CI determines that there was no evidence of criminal tax activity on the 2020 federal tax return. However, based on documentation uncovered and interviews of various parties performed in the course of their investigation, IRS CI believes that Theo and Marlene committed various tax crimes in connection with their residency declaration on their 2014 federal tax return. Prosecutors threaten to charge Theo and Marlene with various tax offenses, including tax evasion, filing a false tax return, and conspiracy to commit offense or defraud the United States.

QUESTION: Can IRS CI/DOJ investigate and prosecute Theo and Marlene for falsifying their residency in 2014 and will they?

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[36] Treas. Reg. §1.937-1(c).

SHORT ANSWER: Based on existing authority, yes, they can, and they might.

ANALYSIS: As discussed above, the statute of limitations for most tax crimes is 6 years. If more than 6 years have lapsed since the alleged fraud, a prosecution would likely be barred. However, if the prosecutor invokes the Wartime Suspension of Limitations Act, the prosecution may be allowed to proceed.

The Wartime Suspension of Limitations Act (WSLA) provides:

> When the United States is at war or Congress has enacted a specific authorization for the use of the Armed Forces, as described in section 5(b) of the War Powers Resolution (50 U.S.C. Sec. 1544(b)), the running of any statute of limitations applicable to any offense (1) involving fraud or attempted fraud against the United States or any agency thereof in any manner, whether by conspiracy or not, …. shall be suspended until five years after the termination of hostilities as proclaimed by Presidential proclamation, with notice to Congress, or by a concurrent resolution of Congress.[37]

In essence, the WSLA suspends or tolls the statute of limitations with respect to any offense involving fraud or attempted fraud against the United States or any agency when the nation is "at war", thereby extending the time for bringing charges. The suspension ends five years after the President proclaims the end of hostilities (with notice to Congress) or Congress passes a concurrent resolution. The WSLA was amended in 2008 to extend the suspension period from 3 to 5 years, make the provisions applicable to an authorization for the use of Armed Forces instead of only a 'declared war', and require a presidential proclamation, with notice to Congress, to signal the end of hostilities and thus end the suspension of the statute of limitations.[38] Various courts have analyzed the application of the WSLA in connection with tax-related offenses. A discussion of a few of those cases follows.

In *Daugerdas v. United States*,[39] a CPA/lawyer was found to be the mastermind behind a decade-long scheme to defraud the IRS by designing, marketing, and implementing fraudulent tax shelters for wealthy clients. The tax shelters were designed as "cookie-cutter products" intended to eliminate or reduce large tax liabilities. The court determined that Daugerdas and his co-conspirators created fraudulent documents and backdated transactions to deceive the IRS about

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37 18 U.S.C. §3287.

38 Wartime Enforcement of Fraud Act of 2008, S.2892, 110th Cong. (2008) (enacted).

39 *Daugerdas v. United States*, 09cr581, 18cv152 (S.D.N.Y. Feb 16, 2021)

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the true nature of these shelters. Daugerdas challenged his conviction using various arguments, one of which was based on the expiration of the statute of limitations. In upholding his conviction, on that point, the court held that authorizations for military force in Afghanistan and Iraq in 2001 and 2002, respectively, met the WSLA criteria, and suspended the statute of limitations for conspiracy to defraud the U.S. in tax matters and mail fraud charges. Daugerdas received a 15-year prison sentence and was ordered to forfeit $164.7 million in illegal proceeds and pay $371 million in restitution to the IRS. The WSLA's role in this criminal prosecution was crucial as the government relied on its tolling provisions to extend the statute of limitations for the conspiracy to defraud the United States and related charges, including mail fraud.

In another case, *US v. David Wellington et al*,[40] the government invoked the WSLA in a matter involving a taxpayer charged with conspiracy to commit tax evasion and defraud the United States. Wellington attempted to have the case dismissed due to the expiration of the applicable 6-year statute of limitations. In response, the government successfully argued:

> In 2001, Congress authorized "the use of the Armed Forces" in response to the terrorist attacks of September 11, 2001….The following year, Congress authorized the President to use military force to "defend the national security of the United States against the continuing threat posed by Iraq" and "enforce all relevant United Nations Security Council resolutions regarding Iraq."….These Authorizations have never been repealed, and no Presidential proclamation has declared the termination of hostilities….The WSLA applies to "all frauds against the United States, including those unrelated to the war," and therefore applies to Count 1 of the indictment, which alleges a conspiracy to defraud the United States.[41] [Internal citations omitted.]

Appeals courts in both the 1st and 11th federal circuits[42] have found that the WSLA suspends the statute of limitations based on the authorizations for use of military force after the September 11th attacks and the 2003 Iraq war.[43] It is worth noting that those authorizations are still in effect today as they have not been repealed or revoked. To further solidify the applicability of the WSLA, the 9th circuit has explicitly held that for offenses involving fraud against the US or

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40 *United States v. Wellington*, No. 1:21-cr-00853-WJ (D.N.M. Aug. 12, 2022).

41 *Id.*

42 First Circuit includes Puerto Rico, Massachusetts, Maine, New Hampshire, and Rhode Island. Eleventh Circuit includes Florida, Georgia, and Alabama.

43 *United States v. Melendez-Gonzalez*, 892 F.3d 9, 15 (1st Cir. 2018), and *United States v. Frediani*, 790 F.3d 1196, 1201 (11th Cir. 2015).

offenses involving property of the US, there is no requirement of a nexus to Congress's authorization of use of military force in order for the WSLA to apply.[44]

Some tax practitioners have advocated for changes to the way the government utilizes the WSLA, overtly acknowledging its applicability to tax offenses. Specifically, in 2021, the American Bar Association Tax Section, chaired by a former DOJ Tax prosecutor, suggested that it was a high priority for the government to issue guidance making it clear that IRS CI will not recommend prosecution for charges that otherwise would be untimely except through the operation of the WSLA.[45] The ABA noted that this guidance is needed to avoid the potentially unlimited statute of limitations in cases involving tax offenses because, if the suspension is applicable, crimes more than two decades old could be recommended and prosecuted. The characterization of this guidance as a "high priority" item by a former DOJ Tax official is intriguing. However, the Wellington case was decided after that request from the ABA and nothing appears to have changed in the DOJ Criminal Tax Manual as a result. It is still silent on the issue.

Lack of Congressional Action since 2008

The absence of legislative changes to the WSLA limiting its application to specific crimes might embolden prosecutors to employ it as a tool to suspend the statute of limitations applicable to tax offenses. Congress amended the WSLA in 2008 through the Wartime Enforcement of Fraud Act, extending the statute of limitations suspension period from three years to five years, and expanded the war-time circumstances under which the WSLA applies. There was no attempt to limit or proscribe the use of the WSLA with respect to certain types of charges, such as tax offenses. In fact, the 9th Circuit court, in *Nishiie*, specifically acknowledged that the WSLA might result in a multiple-decades long suspension of the statute of limitations absent Congressional action:

> Indeed, Congress has seemingly blessed this lengthy tolling even given the modern expansion of the WSLA's war powers. When Congress amended the WSLA in 2008, Congress changed the WSLA's triggering event, providing that suspension of the running of any applicable statute of limitations was available not only "[w]hen the United States is at war" but also when Congress has enacted a specific authorization for the "use of the Armed Forces." Congress also extended the suspension period

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44 *United States v. Nishiie*, 996 F.3d 1013, 1028 (9th Cir. 2021), cert. denied, No. 21-6453, 2022 WL 1205873 (U.S. April 25, 2022).

45 American Bar Association, Tax Section. (2021, May 28.) Recommendations for 2021-2022 Priority Guidance Plan. [Letter to the Department of Treasury]

> from three to five years. Pub. L. 110-417, § 855, 122 Stat. 4545 (2008).*** Readily apparent from the WSLA's amendment history is that Congress is fully capable of changing course and cabining the reach of any statute of limitations if it decides public policy warrants such a change.[46]

Absent any changes to the substantive scope of the WSLA by Congress, or any mention of the WSLA in the IRS Criminal Manual or DOJ Criminal Tax Manual limiting its applicability, is it reasonable to assume that a prosecutor might successfully invoke the WSLA in their case against Theo and Marlene?

Conclusion

In general, the statute of limitations for the IRS to assess additional taxes is generally 3 years from the date of filing a tax return, or 6 years in the case of a 'gross omission'. However, the statute of limitations is unlimited if the IRS can prove civil fraud or if no tax return was filed. If the DOJ decides to prosecute a taxpayer for tax offenses, the statute of limitations could potentially extend many more years if the WSLA applies to suspend the statute of limitations.

Theo and Marlene, in our example above, would be wise to contact competent criminal defense attorneys to discuss their particular facts and circumstances. If the prosecutor successfully utilizes the WSLA, the 6-year statute of limitations might not be a bar to prosecution of their tax offenses in 2015.

As always, we strongly encourage all taxpayers who are contacted by the IRS to engage a competent legal team to perform a review of their facts and applicable statutes of limitations, including a careful review of the potential impact of the WSLA, particularly in the 1st, 9th, and 11th Circuits.

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46 *United States v. Nishiie*, 996 F.3d 1013, 1028 (9th Cir. 2021), cert. denied, No. 21-6453, 2022 WL 1205873 (U.S. April 25, 2022).

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About Tom Duffy, C.P.A., P.A. & P.C.

Tom Duffy C.P.A., P.A. & P.C. is a Greater Chicago-based CPA firm that specializes in international taxation with a particular focus on U.S. possessions. In addition, the firm is one of the few CPA firms in the country that specializes in representing residents of Puerto Rico during IRS examinations, specifically those taxpayers granted tax incentives under Puerto Rico's Act 60 (formerly Act 20/22).

Our foreign clients rely on our knowledge and expertise in complying with their U.S. tax obligations. Tom Duffy has over fifteen years of experience in international tax planning and associated U.S. tax return preparation. The firm services clients in the United States, its possessions, and throughout the world. Tom Duffy is a member in good standing with the American Institute of CPAs and the Puerto Rico Society of CPAs. He is licensed to practice in Florida, Illinois, and Puerto Rico.

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