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News

Tax

Congress Looks to End Strange Loophole Where The IRS Can End Your Tax Court Case by Taking Your Refund

By Yan Wang

In a sharply divided political landscape in Washington, an unusual situation is developing where members of both parties support closing a legal loophole that's befuddled taxpayers with IRS tax issues.

The situation stems from the intersection of taxpayers appealing IRS collection disputes in Tax Court, the expiration of tax deadlines, and the tax agency's ability to intercept taxpayer refunds during this period.

The interplay of these events means that taxpayers can have refunds from other years applied to the liability they are disputing – which can strip their legal right to dispute IRS decisions. The issue – which has gone all the way to the U.S. Supreme Court – has led to rare bipartisan agreement in Washington and generated support from the IRS National Taxpayer Advocate to fix the issue centered on collections and refunds.

In the House, the provision was sponsored by Rep. Nathaniel Moran, R-Texas, with co-sponsor Rep. Terri Sewall, D-Alabama. The provision cleared the House in May by a voice vote – meaning both parties supported the legislation.

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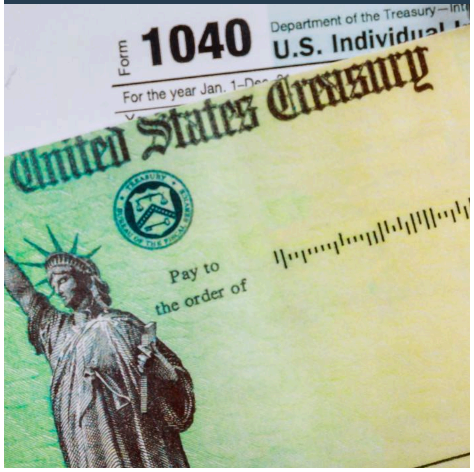

Meanwhile, in the Senate, a similar bipartisan theme has played out. Senate Finance Committee Chairman Mike Crapo, R-Idaho, and ranking Sen. Ron Wyden, D-Oregon, have included the House provisions as part of their broader Taxpayer Assistance and Service (TAS) Act with the support of IRS Taxpayer Advocate Erin Collins. The TAS Act cleared the Finance Committee on July 30 with bipartisan support. But the proposed legislation remains under consideration in the Senate – along with the separate House provision.

"We are strengthening taxpayer rights and ensuring Americans have a clear path to challenge the IRS," Moran said earlier this year. "This legislation advances fairness and accountability in our tax system —guaranteeing no one loses their day in court over arbitrary deadlines or IRS overreach. By protecting taxpayer rights, extending filing windows, and strengthening Tax Court jurisdiction, we are delivering real, lasting safeguards for every American."

The question now centers on whether enough time remains on a crowded legislative agenda – complicated by the November mid-term election – for the provision to get final approval before Congress wraps up legislative work for the year.

But while Congress considers this common-sense solution, taxpayers can be at risk of getting caught in this loophole and losing tax refunds.

For people in this situation, Frost Law can help. Schedule a free consultation with Frost Law by calling (410) 497-5947 .

To help taxpayers understand the current landscape, here's a closer look at this complex situation.

I. The Case That Sparked Congressional Action — *Commissioner v. Zuch*

Imagine a situation that is as incredibly frustrating as it is entirely legal.

When New Jersey resident Jennifer Zuch got divorced, she and her ex-husband, Patrick Gennardo, agreed to split their tax payments. But the IRS made a massive clerical error. They credited their entire joint $50,000 prepayment to her ex-husband's account alone. The IRS then turned around, claimed Jennifer owed them money, and hit her with an asset levy. Jennifer knew she didn't owe a dime. To fight back, she filed a collection due process (CDP) suit in the U.S. Tax Court.

This back-and-forth battle, which began in 2012, dragged on for over a decade, eventually climbing all the way to the U.S. Supreme Court.

But mid-dispute, the IRS noticed that Jennifer had generated new, unrelated tax refunds from her normal filings over subsequent years. That's when the IRS played a quiet procedural game. They intercepted her legitimate refunds, applied them to the old disputed debt, and wiped her balance down to zero.

Because her balance was now zero, the IRS voluntarily dropped the original levy. The Supreme Court ruled in 2025 that since the levy was gone, there was no longer an active legal dispute. They dismissed the case, leaving her with nowhere to turn.

In the end, the IRS quietly took Jennifer's money through the back door, completely stripping her of the right to have a judge decide if the IRS messed up the math in the first place. If she ever wants that money back, her only option would be to hire expensive attorneys and start all over through a refund suit in a federal district court.

This isn't a hypothetical nightmare. It is the exact legal playbook the Supreme Court handed the IRS in *Commissioner v. Zuch*. This aggressive use of a procedural loophole deeply upset many in the legal community, and it became the driving force behind a bipartisan push in Congress to pass the Taxpayer Due Process Enhancement Act (H.R. 6506).

II. How Proposed Legislation Would Strengthen Taxpayer Rights

Legislation moving through Congress would address this gap.

In the House, Moran introduced H.R. 6506, the Taxpayer Due Process Enhancement Act, to respond to the Supreme Court's decision in *Zuch* by closing procedural loopholes that undermine judicial oversight. By codifying three key statutory remedies, this important provision would strip the agency of these procedural shortcuts and deliver a significant structural update to the CDP framework.

Key Change: Tax Court Would Retain Jurisdiction Even If the IRS Withdraws Collection Action

Historically, if the IRS realized it was losing a case in Tax Court, it could suddenly drop the collection action and ask the judge to dismiss your lawsuit. The case was closed, but the underlying tax problem remained a ticking time bomb.

H.R. 6506 permanently ends this practice. If passed, Section 4 of the House bill would end this procedural gap by locking in three major courtroom changes:

- **The Tax Court Gains Absolute Jurisdiction:** Once a taxpayer files a petition, the judge has the explicit power to rule on three critical elements: the collection decision, the actual underlying tax liability (if properly at issue), and whether missing a deadline deserves a fairness exception.
- **The IRS Cannot Force a Dismissal:** If the IRS suddenly backs down or abandons its collection action mid-lawsuit, the court retains full authority over the case. The IRS cannot just say "never mind" to avoid a losing verdict.
- **Taxpayers Get a Final, Binding Judgment:** Instead of the case being thrown out on a technicality, the judge is legally required to issue a merits-based ruling. This guarantees permanent, courtroom-backed protection of taxpayer rights.

Here's a comparison between the current standard and what the proposed legislation would change:

Taxpayer files Tax Court petition ↓	
IRS abandons collection action or automatically offsets debts ↙ ↘	
Old Precedent:	**H.R. 6506:**
• Case dismissed as "Moot" • Taxpayer left without forum • Loophole for IRS maneuvers	• Court retains full jurisdiction • Court issues merits-based ruling • Permanent protection of rights

Key Change: The IRS Could Not Offset Refunds Against a Disputed Liability During a Pending CDP Case

Under current rules, if a taxpayer owes a disputed tax debt from a past year, the IRS can quietly intercept the new annual tax refunds and apply them to that old debt, even while the person is actively fighting the agency in court.

Section 3 of H.R. 6506 puts an immediate freeze on refund offsets. The proposal would safeguard taxpayer money and level the playing field:

- **Tax Refunds Stay in the Taxpayer's Pocket:** The IRS is strictly banned from seizing a taxpayer's current tax overpayments or refunds to cover a disputed debt while a Collection Due Process (CDP) appeal is pending.
- **No Forced Payments Without Consent:** Unless the taxpayer explicitly signs off on it, the government cannot touch new refunds until a judge gives a final ruling on

the case.

- **Equal Protection for Liens and Levies:** The IRS routinely uses different procedural legal loopholes for asset seizures (levies) versus property claims (liens). This amendment requires the IRS to provide the exact same taxpayer-friendly defense rights in both types of cases.

Here's a comparison between the current standard and what the proposed legislation would change:

Taxpayer files CDP appeal on Year 2022 debt ↓	
Taxpayer has a refund in Year 2025 ↙ ↘	
Old Precedent:	**H.R. 6506:**
• IRS automated system seizes refund	• Blocks seizure
• Refund applied to Year 2022 debt	• Refund released directly to taxpayer
• Tax Court case dismissed as "Moot"	• Tax Court case remains active & live
• Taxpayer stripped of due process	• Full merits hearing safeguarded

Key Change: Refund Claim Deadlines Would Be Suspended During the Dispute

Right now, fighting the IRS is a race against time. While taxpayers are locked in a lengthy legal battle over a disputed tax bill, the standard expiration clock keeps ticking on other tax refunds. Far too many taxpayers win their main case only to find out that their deadline to claim separate overpayments has expired—leaving their money permanently trapped in government hands.

Section 2 of H.R. 6506 hits the pause button on the IRS clock. It introduces a powerful statutory freeze to make sure taxpayers never lose money due to a pending court case:

- **Tax Deadlines Are Frozen:** The strict legal time limits for claiming tax credits or refunds are completely suspended the moment an appeal is pending.
- **Time is Preserved for the Entire Fight:** The clock stays frozen for the exact duration of the dispute. You do not lose a single day of your eligibility while the taxpayer's attorney fights for the case.
- **No More Deadline Traps:** The IRS can no longer run out the clock or rely on bureaucratic delays to strip away the taxpayer's right to get their money back.

Here's a comparison between the current standard and what the proposed legislation would change:

Taxpayer enters CDP hearing to dispute underlying debt ↓	
Statute of limitation expires Mid-dispute ↙ ↘	
Old Precedent:	**H.R. 6506:**
• Clock keeps ticking during dispute	• Statutory pause suspends statute deadline
• Taxpayer trapped in administrative delay	• Limitation period frozen while CDP pending
• Deadline passes prior to court ruling	• Time preserved for duration of dispute
• Right to refund permanently forfeited	• Taxpayer retains right to claim overpayment

III. Practical Advice for Taxpayers

While H.R. 6506 moves through Congress, the IRS is still playing by the old *Zuch* rules. For taxpayers to protect their money and against the IRS using procedural shortcuts, here are four smart strategies for taxpayers to consider using right now:

1. File a Protective Claim to Save Your Refunds

Under current post-Zuch rules, battling with the IRS in Tax Court does not pause the standard three-year deadline to claim other annual tax refunds. This means many taxpayers successfully win their main lawsuit only to discover that their separate, unrelated refunds have legally expired and are gone forever. Instead of sitting back and waiting for a court decision, taxpayers should be proactive: If they have an upcoming refund that is approaching its three-year expiration date, immediately file a "Protective Claim for Refund" to officially freeze the clock and safeguard the money while the active litigation plays out.

2. Zero Out Future Tax Refunds

Right now under this scenario, the IRS can offset new annual tax refunds and apply them to the old disputed debt in the middle of litigation. Once that forced seizure brings the account balance down to zero, the IRS can strategically drop its levy and force the Tax Court to throw out the lawsuit as moot. To stop this procedural game in its tracks, taxpayers should immediately review their current tax planning and adjust employee withholdings or quarterly estimated tax payments to make sure the year-end refund is as close to zero as possible. When taxpayers ensure they do not overpay throughout the year, they drain the pool of extra cash available for the IRS to seize, preserving their right to a day in court.

3. Fight Back If the IRS Tries to Drop the Case

If the IRS realizes it is losing the case, it may suddenly drop the levy and ask the judge to dismiss the lawsuit under the guise that the "problem is solved." Taxpayers should never assume the IRS is admitting defeat when they use this tactic; instead, the taxpayer's attorney must immediately object to the dismissal in court. The legal team should firmly argue to the judge that the core tax disagreement remains unresolved, demanding that the court retain jurisdiction and keep the case open until a final, binding verdict on the merits is reached.

4. Keep Perfect Records for a Backup Federal Case

If the IRS successfully uses the Zuch loophole to shut down a Tax Court case, the taxpayer's only remaining option is to pay the full disputed bill upfront and sue the government for a refund through a regular – and highly expensive – federal district court case. To reduce this risk, taxpayers should prepare for the worst from day one by keeping every piece of IRS mail, hearing memorandum, and payment receipt meticulously organized. Treating administrative records as if they are headed straight to a high-level federal trial ensures that a flawless paper trail will serve as the taxpayer's best shield if circumstances mean the case must switch court systems.

IV. Conclusion

Whether H.R. 6506 ultimately passes or not, this scenario is a wake-up call for taxpayers, particularly those with tax issues. It shines a bright light on the tactics the IRS is currently allowed to use under the Zuch precedent.

Because the 2026 congressional calendar is packed and time is running short in an election year, there is no guarantee this legislation will cross the finish line this year. Taxpayers and businesses cannot afford to wait for Congress to fix the system—they should review their tax strategies, track refund deadlines, and protect their assets right now before this scenario develops.

Taxpayers with questions about this issue can reach out to Frost Law. Contact our team today at **(410) 497-5947** or **schedule a confidential consultation**.

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