



## **The Government Learns a Costly (\$24 Million) Lesson in Pleading** **by Robert Horwitz**

Rule 12(b) of the Federal Rules of Civil Procedure allows a defendant to raise certain defenses in its responsive pleading or by motion, including under 12(b)(6), failure to state a claim upon which relief can be granted. A 12(b)(6) motion was a favorite motion of attorneys of the late Tax Division to get rid of cases that were frivolous or time barred. The tables were turned on the Government in *United States v. Phelps*, Case No. 7:25-CV-241-BO-BM (ED NC 11/18/2025). As a result, due to inartful pleading and a failure to move to amend the complaint, the Government's suit to collect \$24 million in taxes, penalties and interest was dismissed with prejudice.

The lawsuit was filed by the Government on January 27, 2025. The facts as pled in the complaint was that \$11,706,865 tax for 2012 was assessed against defendants Calvin Phelps and his wife, Lisa Yamaoka, on September 29, 2014, and that the balance owed with accruals was \$24,146,385.41. The Government sought to reduce the assessment to judgment and to foreclose its tax liens against real property owned by the defendants. The complaint named as additional defendants lienholders against the property.

If you are a tax procedure maven, you would have noticed two things. First, that given the assessment date, the defendants had probably filed a late return for 2012. Second, and more important, given the ten-year statute of limitations on collection under IRC §6502(a), the complaint was filed after the statute of limitations had expired, unless an event tolled the statute. The defendants' attorney realized this and filed a 12(b)(6) motion, arguing that the facts pled in the complaint (which are assumed to be true for purposes of a motion to dismiss) established that the complaint was time barred.

Rule 15 (a) of the Federal Rules of Civil Procedure allows a plaintiff to amend a complaint as a matter of right within 21 days after a 12(b)(6) motion; after that time, a pleading can be amended only with the written consent of the opposing party or with leave of court, which should be "freely given[n] when justice so



requires.” The Government did not file an amended complaint within 21 days or file a motion for leave to file an amended complaint after the 21 days expired. Instead, it opposed the motion, arguing that the defendants had requested an installment agreement which was granted and then terminated, and that under IRC §6502(a)(2)(A) this tolled the statute of limitations until February 8, 2025, making the complaint timely.

The district court was not persuaded. The Eastern District of North Carolina is within the Fourth Circuit. Under Fourth Circuit case law, a complaint does not need to allege facts relevant to a potential affirmative defense except where the complaint on its face is time-barred. The district court applied this rule, noting that nothing on the face of the complaint or any attachment to the complaint suggested that the statute was tolled.

Where a plaintiff does not formally request leave to amend, whether the court grants an informal request is discretionary. The court noted that the Government could have amended the complaint within 21 days without leave of court or could have filed a formal motion to amend after that time. It did neither. Instead, it requested to amend the complaint at the hearing. The court therefore denied leave to amend the complaint and dismissed the case with prejudice. Since no affirmative relief was sought against the lienholders, they were also dismissed and the case was concluded.

After judgment is entered, the Government can appeal to the Court of Appeals for the Fourth Circuit and argue that under Rule 15(a)(2) the district court should have granted leave to amend since “justice so requires,” pointing out that the defendants escaped paying over \$24 million allegedly owed to the Government. Whether the Government will appeal and whether the appellate court will reverse the district court’s denial of the “informal” motion remains to be seen.

Lessons to be learned from this case are (1) if you are preparing a complaint that, on its face, may be time-barred, plead facts showing why the statute of limitations was tolled; (2) if the opposing party moves to dismiss a complaint



or counterclaim and you can easily cure the perceived defect by filing an amended pleading, do so as soon as possible, not after the court rules on the motion, and (3) when you are responding to a complaint or counterclaim consider moving to dismiss if there are grounds for doing so rather than raising an affirmative defense.

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