

Steve Leimberg's Income Tax Planning Email Newsletter Archive Message #146

Date:02-Jul-18

Subject: Kevin E. Packman & Andrew H. Weinstein - Do Not Lose Your Right to Money! How to Timely Identify and File for a Tax Refund

“As a result of the complexity of the Internal Revenue Code and introduction of new provisions courtesy of Congress, taxpayers are challenged with filing correct and accurate tax returns. Taxpayers can make mistakes, which can be resolved proactively through an amended return, or defensively through an examination. Regardless of how and why a mistake was made, the result can often be the taxpayer is entitled to a tax credit or refund. This newsletter will review the process by which the taxpayer is entitled to a refund and discuss the applicable statutes of limitation (SOL) for seeking a refund in examination, administrative appeals, and in the United States Tax Court (USTC). These issues are also relevant to refund litigation in United States District Courts and the United States Court of Federal Claims.”

Kevin E. Packman and **Andrew H. Weinstein** provide members with commentary that reviews how to timely identify and file for a tax refund.

Kevin E. Packman is a partner in the Miami, Florida, office of **Holland & Knight LLP**. He chairs the firm's Offshore Compliance Team and International Estate Planning Group. He is also a fellow of the American College of Trust and Estate Counsel. Kevin also serves as **Technical Editor** of **LISI**'s International Tax Planning Newsletters.

Andrew H. Weinstein is a partner with **Holland & Knight LLP**'s Private Wealth Services Group and the Taxation Team. Mr. Weinstein's primary focus is on representation of high-net-worth individuals, both domestic and international. Mr. Weinstein has many years of in-depth experience within the IRS and in the private sector, having acted for clients with net worth in the billions of dollars. While at the IRS, Mr. Weinstein was responsible for both federal criminal tax enforcement and civil tax disputes, including substantive examinations, collection proceedings, administrative appeals

and tax litigation. In the private sector, Mr. Weinstein leverages his government experience in representing individuals, companies, trusts and estates to ensure that their international, federal, state and local tax-related planning and compliance withstands governmental review at every level. Mr. Weinstein is a Fellow of the American College of Trust and Estate Counsel and the American College of Tax Counsel and is Florida Bar Board Certified in Tax Law.

Here is their commentary:

EXECUTIVE SUMMARY:

As a result of the complexity of the Internal Revenue Code and introduction of new provisions courtesy of Congress, taxpayers are challenged with filing correct and accurate tax returns. Taxpayers can make mistakes, which can be resolved proactively through an amended return, or defensively through an examination. Regardless of how and why a mistake was made, the result can often be the taxpayer is entitled to a tax credit or refund. This newsletter will review the process by which the taxpayer is entitled to a refund and discuss the applicable statutes of limitation (SOL) for seeking a refund in examination, administrative appeals, and in the United States Tax Court (USTC). These issues are also relevant to refund litigation in United States District Courts and the United States Court of Federal Claims.

COMMENT:

Timeliness

In order to be entitled to a refund, the taxpayer must have overpaid a tax [Sec. 6401]. The IRS is authorized by law to refund overpayments within the applicable SOL [Sec. 6402]. A claim for refund must be filed on a timely basis. However, the element of timeliness varies. The applicable time frame is generally three years from the date the return was filed or two years from the date the tax was paid, whichever is later [Sec. 6511(a)]. While special rules exist for certain income tax credit carrybacks, foreign tax credits (FTC) and other items [Sec. 6511(d)], only the FTC will be specifically addressed in this article because of the complexity of the applicable provisions [Sec. 6511(d)(3)(A)].

When seeking a refund related to a FTC, the applicable time frame is extended to 10 years [Sec. 6511(d)(3)(A)]. The initial year from which the

SOL commences to run is not the year or years to which the FTC is carried forward. Rather, the 10 year measuring period commences with the date prescribed by law for filing the return for the year in which the foreign tax was paid or accrued, excluding any extension of time to file the return for that year [Treasury Regulations Sec. 301.6511(d)(3)(A)]. This contrasts with the normal three year rule where the measuring period begins from the date the return for the year the tax is to be refunded was filed, including an extension of time to file the return [Sec. 6511(a)]. A recent appellate case in the Fifth Circuit explains that the refund must be attributable to the FTC to be allowed the extended 10 year period or the claim will almost always be untimely under the three year rule. *Schaeffler, et al. v. U.S.* 121 AFTR 2d Par. 2018-710, (5th Cir. 5/22/18).

To be confident that the claim for refund will be allowed, a taxpayer must file the claim within the applicable time frame. Otherwise, and with very limited exceptions (mitigation [Secs. 1311-1315] or equitable recoupment [Bull v. United States, 295 U.S. 247 (1935)] that are beyond the scope of this article, an overpayment will not be credited or refunded. However, does Section 6501(c)(8), which extends the SOL for assessment when a taxpayer fails to file one of several complete and accurate information returns, also extend the time for a taxpayer to file a claim for refund? Typical situations in which this could arise occur with the failure to file Forms 3520, 5471 or 8938. The SOL for assessment does not commence to run until the required form is filed [Sec. 6501(c)(8)]. The referenced section is silent on whether the refund SOL is also open when the assessment SOL is open. Similarly, there is no regulation, ruling, treatise, legislative history or other authority that addresses the issue. This should be compared with the General Explanation of Tax Legislation, 111th Congress, Joint Committee on Taxation, par. 5, pages 232-234, March, 2011.

Amount of Refund

It stands to reason that the taxpayer's claim for refund must be limited to the overpayment during the applicable period. The statute states that the amount of the refund shall not exceed the tax paid within the above referenced three year period, plus any (timely filed) extension of time for filing the return [Sec. 6511(b)(2)(A)]. If the claim is not filed within the three year period, the refund shall not exceed the tax paid during the two years immediately preceding the filing of the claim [Sec. 6511(b)(2)(B)].

The time for filing a claim or for making a refund if no claim is filed is extended to six months after the period for assessment in those instances where there was a timely executed waiver of the SOL on assessment [Sec. 6511(c)(1); 6501(c)(4)]. If a taxpayer signs a Form 872 – Consent to Extend the Time to Assess Tax (or similar agreement to extend an SOL), a claim for refund can be filed within the extended period of time, but it must relate back to a year that is covered by the extension. The refund, however, shall not exceed the tax paid after execution of the agreement and before the filing of the claim, as applicable, plus the tax paid within the two year period when no claim was filed [Sec. 6511 (c)(2)].

As a general rule, if there is an agreed extension of time to assess, the three year refund SOL also remains open [Sec. 6501(a); 6501(c)(4); and 6511(c)]. In a recent case settled in the USTC, IRS Counsel took the position that because Section 6501(c)(8) does not contain a similar reference (as contained in Section 6511(c) to the refund statute being extended when there is a Form 872), a refund claim cannot be filed during an extended period under 6501(c)(8). Unfortunately, by the time a Sec. 6501(c)(8) issue is typically identified by IRS, it is too late to execute an agreement to extend the SOL on assessment.

Counsel would be wise to file a Form 872 (or similar extension for assessment) upon identifying a Section 6501(c)(8) violation if the underlying refund statute remains open. This will prevent a situation from arising where there is a disconnect between Sec, 6501(c)(8) and Sec. 6511(c). There are severe limitations on the authority of IRS to credit or refund overpayments and the taxpayer must exercise due diligence to ensure that overpayments are credited or refunded.

Litigation

1. U.S. Tax Court

Taxpayers should be aware that while certain statutes are tolled during the commencement of litigation, such as collections, the USTC also has limited jurisdiction to order a refund [Sec. 6512]. If the USTC determines that there is an overpayment, the USTC has jurisdiction to order a refund [Sec. 6512(b)(1)]. The limitations can, however, be mind boggling. The amount of the refund is limited to tax paid (i) after the mailing of the notice of deficiency; (ii) within the above referenced Sec. 6511 periods if a claim was filed; (iii) within the "deemed filed" date of the mailing of the notice of deficiency; (iv) if a claim was actually filed within the applicable Sec. 6511

period and before the mailing of the notice of deficiency; (vi) that was not disallowed before the mailing date; or (vii) that was disallowed before that date and a suit for refund could have been filed; or (viii) was actually timely filed [Sec. 6512(b)(3)].

2. Refund Litigation

There may be instances in which the IRS refuses to issue a refund when a claim was timely filed. In such instances, taxpayers may elect to litigate the denial of the refund. However, there are also statutes related to the commencement of refund litigation. Subject to certain exceptions, a suit for a refund may not be commenced before six months from the date of filing of the claim, nor more than two years after the claim is disallowed [Sec. 6532(a)]. Refund jurisdiction exists only if a claim was timely filed [Sec. 7422(a)]. Jurisdiction is provided by the Judicial Code [Title 28] and not the Internal Revenue Code [Title 26].

It is critical to not only file a timely claim for a refund, but also to commence a timely suit for the refund.

3. Criminal Tax Matters

While not relevant to the filing of a refund, counsel should be aware that in a criminal tax proceeding related to an underpayment of tax, the extended statute of limitations for FTC can be helpful. The FTC is available to reduce the tax loss for sentencing guideline purposes. In effect, an FTC claim can result in a reduced tax loss for a prior tax year [United States v. Tilga et al. Memorandum Opinion and Order USDCDNM, No. CR 09-0865 JB (11/8/11); Weinstein, Using Extended FTC S/L to Defend Against Tax Evasion Charges, JTAX (December 2011); Rubinger and Weinstein, "Foreign Tax Credits: Can a Deficiency Be Retroactively Wiped Out for Criminal Tax Evasion Purposes?," 112 JTAX 166 (March 2010)].

Deemed Tax Payments

As noted above in the discussion related to refunds available in the USTC, the Code provides guidance to determine when returns are deemed filed and taxes are considered paid [Sec. 6513]. These provisions can effectively serve to bar a refund. Withheld and estimated taxes are deemed to be paid on April 15 of the year next following the end of the tax year, without regard to any extensions of time to file the return [Sec. 6513(b)]. The effect of the deemed payment date is that a refund may be barred for such amounts unless a claim is filed within the applicable three

year or two year period [Sec. 6511]. Indeed, Sec. 6511(i)(1), the limitations on credit or refund, cross references Sec. 6513. This effectively results in the deemed payment date of Sec. 6513 serving as a limitation on the refund. Additionally, USTC Rule 34(b)(4) requires a taxpayer to specifically plead entitlement to the refund. Although the assessment statute is tolled following the issuance of a Notice of Deficiency [Sec. 6503(a)(1)], when a taxpayer files a timely petition in the USTC, the USTC may order a refund of tax collected during the tolled period [Sec. 6213(a)].

Notwithstanding, this does not extend the SOL on the filing of a claim to cover deemed tax payments. By way of contrast to Sec. 6511, there is no similar cross reference to extensions of time to assess tax [Sec. 6501(c)(4)] in the provisions covering limitations in case of petitions to the USTC [Sec. 6512]. As such, the existence of a waiver of the SOL on assessment will not preserve the right to a refund involving deemed payments of tax, absent a timely claim for the refund.

Offshore Voluntary Disclosure Program

The still pending IRS Offshore Voluntary Disclosure Program (OVDP) requires a participating taxpayer (Participant) to sign a Form 872 extending the SOL on assessment for the immediately preceding eight years [IRS Offshore Voluntary Disclosure Program, Frequently Asked Questions and Answers, 2014, Q&A #9]. This is not a statutory requirement, but rather is imposed as an administrative prerequisite to participation in the OVDP. Consequently, even though the Participant agrees to the extension of time to assess for the eight years, such extension does not serve to extend the refund claim periods. IRS compliance programs that require waivers of the SOL on assessment do not serve to extend statutory refund claim filing requirements. Notwithstanding, the Participant may file a claim for refund within two years of submitting the payment required by the OVDP. However, this would necessitate the Participant to opt out of the OVDP.

The IRS authority to allow a refund or the USTC to order a refund is limited by statute [Sec. 6402; 6511; 6512]. Like rules and limitations on refund litigation in other Federal Courts apply to such proceedings [Sec. 6532(a)(1); 7422(a); 7422(k)(1) cross referencing Chapters 65 and 66].

It is important to distinguish between an extension of time to assess for an otherwise closed tax year and an extension of time to assess for an open tax year. Only the extension of time to assess for an open tax year will

permit an extension of the date for filing the refund claim. Note also that for a waiver of the SOL on assessment to be timely, it must be executed before the expiration of the SOL on assessment [Sec. 6501(c)(4)(A)]. In this sense, OVDP has the same limitations as failure to timely notify.

Erroneous Refund Claim

Is there any reason a taxpayer or tax professional should not always file claims for a refund? Simply stated, the Code contains provisions for the IRS to penalize a taxpayer who files an erroneous refund claim (Section 6676) as well as a preparer (Sec 6694). So long as the taxpayer has a reasonable basis for seeking a refund, the penalty should not apply. Similarly, if the preparer has substantial authority or discloses the position, which is not frivolous, preparer penalties will not apply. The filing of a refund claim must have a reasonable basis, whether on a protective return or complete return, and should not result in the imposition of any penalties. The preparer should consider filing of form 8275 whenever disclosure is appropriate.

Putting it All Together – A Hypothetical Example

Assume a taxpayer joined OVDP at a time when 2003-2010 are the applicable tax years. On such date, the taxpayer was required to file a Form 872 that would open otherwise barred years, 2003-2007, as 2008-2010 remained open. However, the taxpayer never signed or returned the Form 872 to IRS. Consistent with the OVDP, the taxpayer filed amended returns for 2003 through 2010 and paid all required tax. When an agent is assigned to the case, the agent immediately seeks the Form 872, which is not provided. The taxpayer would have been removed from the OVDP, but elected to opt out.

Following examination of the returns for 2003-2010 during the opt out, a notice of deficiency is issued. By refusing to file a Form 872, filing a Protest to Appeals is not an option, but a petition is timely filed in the USTC. A refund is pled in the petition, but not with respect to all of the specific refunds to which the taxpayer was eligible.

IRS argues that as a result of Section 6501(c)(8), the assessment statute remains open for all years. The taxpayer timely paid estimated tax for 2003 which was deemed paid as of April 15, 2004 [Sec. 6513]. No claim seeking a refund was filed during the pendency of OVDP or during the opt out. IRS Counsel transfers the file to appeals. Late in the appeals process, it is agreed that refunds are appropriate, the basis for which was never

contemplated during the examination process or at the time of filing the petition. A basis of settlement is reached with Appeals in the USTC proceeding to include overpayments.

IRS Counsel's position is that the 2003 estimated tax was deemed paid as of April 15, 2004, and is not a refundable overpayment for the reasons set forth above. Counsel does not dispute the refund for taxes paid with the amended returns [Sec. 6511(b)(2)(B); 6512(b)(3)(B)]. IRS will prevail because a claim for the 2003 estimated tax overpayment was not filed prior to April 15, 2007. The claim must be timely filed even though the SOL was otherwise open for assessment of additional tax for 2003.

How to File for a Refund

1. Final Claims

When seeking a refund for personal income tax, generally a Form 1040X should be filed. When seeking a refund of estate and gift tax, generally a Form 843 is filed. Claims may either be ripe for filing in the sense that they are complete, or they may be protective, described below.

2. Protective Claims

When a claim for a refund is filed on a protective basis, it means that the basis for the refund (for example pending litigation) is not yet complete. However, filing the protective claim will toll the applicable statute of limitations, which will permit time for the claim to become ripe. When filing a protective claim for personal taxes, a Form 1040X is used. Similarly, when filing a protective claim for estate or gift tax, a Form 843 is used. However, when the protective claim is connected to estate administrative expenses, then a separate Schedule PC should be attached to the original Form 706. On any return filed on a protective basis, the taxpayer should write at the top of the return that it is being filed on a protective basis.

3. Informal Claims

Taxpayers can actually put the IRS on notice that a claim for refund will be filed without actually filing a formal claim. There is a body of law on informal claims, but it may result in further disputes as to whether it meets the criteria for a valid claim. The informal claim must be in writing, include a request for refund for the specific tax years, inform the IRS of the basis for the claim and provide sufficient information for IRS to examine the claim. [Blog, Edward M. Robbins, Jr., Filing an Informal Claim for a Tax Refund

(6/8/15), citing to United States v. Kales, 314 U.S. 186 (1941)]. An informal claim will be deemed timely even if when formally filed it is untimely.

Summary

A timely claim is critical to seeking a refund of overpayments. Careful attention must be given to payments that have a deemed date of assessment or have unique provisions as in the case of the FTC. Even though it may be difficult to identify that a refund exists during the statutory period, the absence of clairvoyance is not a defense to the failure to timely file a claim. Consequently, if in doubt, file the claim on a protective basis. The critical conclusion is that even if there is a remote possibility that a refund of an overpayment may be in order, a claim for refund should be timely filed.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Kevin Packman

Andrew Weinstein

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