The Trouble with Large Corporate Refund Claims

By Howard M. Weinman

Howard M. Weinman explores unexpected refund claim problems facing the large corporation.

Refund claims can appear deceptively simple. This article explores how several very large corporations (many of them household names) have recently encountered unexpected refund claim problems. Some have worked their way out of these difficulties through ingenuity or good luck; others have suffered a loss of the claim. These cases illustrate the many potential pitfalls and highlight the care that must go into submission of such claims. If companies of this size and sophistication can have these problems, they can happen to anyone.

When Must a Refund Claim Be Filed?

The time within which a refund claim must be filed has led to some confusion and close calls, though the basic principles are clear. Under Code Sec. 6511(a), a claim must be “filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later.”

The three-year period parallels the period for assessing tax, which may be extended (and often is) by signing Form 872, Consent to Extend the Time to Assess Tax. As provided in that form and in Code Sec. 6511(c), the period for filing refund claims expires six months after the extended period for assessment specified in Form 872 expires. Many taxpayers wait to file until the six-month period, so the IRS cannot assess additional tax for the year.

In RadioShack Corp., a case involving the long-distance telephone excise tax, the taxpayer unsuccessfully attempted to circumvent the three-year rule. The tax applied to charges for telephone service that were based on time and distance. In the 1990s, carriers changed their long-distance charges to base them on time alone, but the IRS continued to insist that the tax was due. Following what the court described as “countless lawsuits” decided in favor of taxpayers on this issue, the IRS relented in 2006. In that year, RadioShack filed a refund claim with the IRS for excise taxes it had paid in 1996. The IRS denied the claim as having been filed beyond the statute of limitations, but RadioShack argued that since it had never filed any telephone excise tax returns (the returns were filed by the carriers), the three-year rule did not apply to it. The court rejected that argument, holding that Congress clearly had not intended to keep the period for filing refund claims open indefinitely, and that the statute of limitations would apply if a return was filed by anyone.

The two-year period can apply where a tax payment is made subsequent to filing the return, e.g., after an IRS audit. Assume, for example, that a corporation paid $100 million in tax with the return and after settling in Appeals paid an additional $10 million of tax. The last Form 872 filed has expired, as has the additional six-month window for filing a refund claim provided by the Form 872. The corporation can still file a refund claim within two years after it pays the $10 million, but the refund will be limited to the $10 million amount. Note that the grounds for the refund are not limited to the issues for which the corporation paid the additional $10 million; that only sets a dollar limit. The refund can be based on entirely different issues.

When relying on the two-year rule, there may be difficulties in determining the date that the tax was
“paid.” This is easy to determine when the taxpayer makes an actual payment, but large corporations often satisfy liability for one year by crediting an overpayment from another year against the liability. This happens when a large deduction is deferred from one year in an audit cycle (resulting in a deficiency) to the next year (resulting in an overpayment).

A very close call is illustrated by **Parker Hannifin Corp.** Parker Hannifin paid part of a deficiency for 1987 by crediting an overpayment from 1988. The taxpayer’s IRS transcript of account showed the date the credit was posted as March 1, 1999. A refund claim for 1987 was perfected on February 23, 2001, so Parker Hannifin clearly thought it had filed the refund claim within the two-year period, with several days to spare.

Not so, said the Justice Department. The government argued that the credit was “allowed” on February 22, 1999, when an internal IRS document, Form 2188, **Voucher and Schedule of Overpayment and Overassessment**, was signed by an IRS employee. Based on that date, the refund claim was a day late. The court agreed, at least for purposes of analysis, with the Justice Department that the date the Form 2188 was signed governed. Parker Hannifin, of course, had never seen this form and had no idea that the March 1 date on its transcript would not be the operative one. However, in a lucky break for Parker Hannifin, the IRS had already thrown the Form 2188 away and could not prove the exact date on which it was signed. Under those circumstances, the court allowed the refund claim to proceed.

Note that **Parker Hannifin** also indicates that, when an amount paid for one year is credited against another year’s liability, the date of “payment” is the date of the credit, not the date the money was originally paid to the IRS. Each year’s liability is treated separately for this purpose.

There are special rules relating to the statute of limitations for carrybacks. Generally, if the source year is open under the three-year rule, the carryback year is open to take the carryback deduction. The special carryback rule only affects the three-year rule. The two-year rule does not apply to the extent of taxes paid on the source year within the last two years. The taxpayer would have to see if it paid tax on the carryback year within the last two years. That is, assume that a corporation has an NOL in year 3 that it carries back to year 1. Even if the three-year statute of limitations for year 1 has expired, the corporation can file the NOL refund claim for year 1 as long as the statute of limitations is open for year 3. If it has lapsed, the corporation can still file a refund claim to the extent that it paid tax for year 1 within the last two years. It does not matter (as far as the NOL carryback claim is concerned) if the corporation paid tax for year 3 within the last two years.

The special rules protect only carrybacks, not carryovers. In **Electrolux Holdings, Inc.** the taxpayer had a capital loss in 1994 that was limited by the consolidated return loss disallowance rules (LDR) as then promulgated. A Form 872 extended the statute of limitations on 1994 to December 31, 1999. On that date, Electrolux filed refund claims on the basis that LDR was invalid. Electrolux had a capital loss carryback claim to 1993 and carryover claims to 1995–1998. At the time that Electrolux filed the claims, the three-year statute of limitations for 1993 and 1995 had expired, but the statute of limitations for the remaining years was open. After the **Rite Aid** decision invalidated LDR, the IRS allowed the claims for all years except 1995, because that was a carryover claim and the refund statute of limitations had already expired for 1995 by the time Electrolux filed its claims. The Federal Circuit sustained the disallowance.

**Who Files the Refund Claim?**

In a consolidated return, the parent files as agent for all members. However, if a corporation takes over another consolidated group, and the claim relates to the acquired group’s years before it was acquired, the former parent files the claim. If one corporation files as successor to another, the claim is filed in the name of the predecessor, followed by the name of the successor. Documentation establishing the successorship must be attached to the claim. The refund claim must be signed by an officer of the filing corporation. If this is a subsidiary, great care must be taken that the signing individual is actually an officer of the subsidiary, not just of the parent. If not, the claim may be invalidated.

One taxpayer attempted ingeniously to use these rules to its advantage in **Browning-Ferris Indus., Inc.** Browning-Ferris was acquired by Allied Waste and converted to an LLC. For a tax year prior to the acquisition, Browning-Ferris had undertaken a contingent liability transaction that the IRS disallowed as a tax shelter. Browning-Ferris paid the tax and filed a refund suit in the Court of Federal Claims, which had just decided a similar case favorably.
Then, before Browning-Ferris’s case was heard, the Federal Circuit reversed the favorable case. Instead of being in a favorable forum, the taxpayer was now in a hostile one. However, there was still time for the taxpayer to file a new refund claim and bring a suit elsewhere if it could extricate itself from the current suit. The taxpayer hired new lawyers, who argued that Browning-Ferris, as a disregarded LLC, could not have filed a valid refund claim; hence, the suit had to be dismissed. The Court of Federal Claims agreed with this argument, but the Federal Circuit reversed and held that the LLC, under the applicable regulations, still had enough life to file the refund claims.

The Variance Doctrine

Perhaps there is no greater difficulty with refund claims than the variance doctrine, which, in essence, states that once the statute of limitations for filing a refund claim has expired, the taxpayer may generally not assert facts or grounds to support the claim that are at variance with the facts and grounds already set forth. Form 1120X, which for complex refund claims perhaps lulls the taxpayer into believing that not much needs to be said, requires the taxpayer to attach computations and any changed forms; there is one page to explain the basis of the claim.

In contrast, the applicable regulations are much more specific:

No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed before the expiration of such period. The claim must set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof. ... A claim which does not comply with this paragraph will not be considered for any purpose as a claim for refund or credit.

Thus, the refund claim may need to be quite elaborate, specifying each ground, including possibly many alternative grounds, for allowing the refund, and specifying facts sufficient to support each ground. The taxpayer may not want to show the government all its alternative arguments, but the variance doctrine forces it to do so. This puts the taxpayer in the strategic dilemma of having to raise alternative treatments that are not as favorable to it but that the IRS or a court may like better than the principal ground.

Remember that variance only applies after the statute of limitations on filing a refund claim has run. The taxpayer can amend or refile a claim before then to add a new ground. The variance doctrine is based on the bar of the statute of limitations.

Factual Variance

How does variance work in practice? An excellent example of factual variance is provided by Lockheed Martin Corp. Lockheed Martin had filed research credit (R&E) claims. The claims specified dollar amounts of qualified research expenses (QREs) for each of Lockheed Martin’s divisions and were accompanied by books having supporting schedules for the largest contracts. The IRS disallowed the claims, and Lockheed Martin filed suit. While preparing for trial, Lockheed Martin discovered that it had additional QREs for one of the large projects and asked the court to include those costs in the suit. Note that discovery of important new facts happens all the time in litigation, no matter how careful the taxpayer has been to accumulate data beforehand. The court held that the additional costs could not be included, even though they would have been allowed on the same legal basis as the others. The new amounts were a substantial factual variance from the filed refund claims.

In this regard, there is an extraordinary contrast between refund claims, which are subsequently heard in a refund forum (district court or the Court of Federal Claims), and affirmative grounds (having the same effect) raised in a Tax Court proceeding. The Tax Court, of course, is normally associated with taxpayers in a deficiency, rather than a refund, posture. Indeed, a statutory notice of deficiency is a prerequisite to filing a Tax Court suit. However, the taxpayer may raise affirmative grounds in a Tax Court proceeding to reduce a deficiency. These grounds
may even result in the Tax Court’s determining that the taxpayer is entitled to a refund.19

Compare the unfavorable result in *Lockheed Martin* to what happened in *Norwest Corp.*20 That case involved the years 1983–1989, and the court described the procedural status as follows:21

Following the filing of the petitions contesting respondent’s determinations, petitioner engaged Coopers & Lybrand ... to ascertain whether it was entitled to [the R&E credit] between 1986 and 1993 with respect to certain internal use software development activities. Coopers & Lybrand concluded that 67 of 118 internal use software development activities petitioner engaged in qualified for the R&E credit. On the basis of the Coopers & Lybrand study, petitioner sought and was permitted to amend its petitions to claim the R&E credit for 1986 through 1989.

In other words, Norwest did not even start its R&E study until the suit was already filed, but its claim was fully considered without mention of the “variance” doctrine, which applies only to refund suits. This may be an important consideration in deciding whether to pursue an affirmative adjustment as a refund claim or in a deficiency case.

**Legal Variance**

Just as *Lockheed Martin* illustrated the problem of factual variance, *Computervision Corp.*22 illustrates the problem of legal variance.

The facts of the case are complicated, but insofar as the variance point is concerned, the issue was whether the taxpayer had timely asserted its right to a refund of interest it had paid because the IRS had miscalculated the date of application of a “credit-equal” payment.23

The IRS asserted that Computervision had a deficiency for 1982, in part because its DISC was not qualified. An NOL carryback from 1985 wiped out any 1982 tax liability, but the taxpayer still owed restricted interest from the due date of the 1982 return to the due date of the 1985 return. Computervision paid the interest and filed a timely refund claim in 1989 for the interest attributable to the DISC issue but not other issues also involved in the 1982 deficiency. Subsequent litigation in the Tax Court for the taxpayer’s 1983 and 1984 years established that the DISC was qualified after all. After the Tax Court decision, the government conceded that interest for the 1982 year was not due insofar as it related to the DISC issue.

In 2000, the IRS prepared computations for the 1982 year that gave Computervision the benefit of the IRS’s new favorable position on interest involving credit-elect payments under Rev. Rul. 99-40, stating that “[n]o claim is necessary.” The Justice Department, however, disagreed with the IRS computations. It said that Computervision could not benefit from the new IRS position because the taxpayer had not specified that as a basis for the refund of interest in its original claim. Note that the government took this position even though Computervision had included the usual catchall request in its refund claim asking that the refund also be based on “such other grounds as are shown to be appropriate.”

The court agreed with the Justice Department. It noted several exceptions to the variance doctrine, but held that none applied.24 Apart from illustrating the application of variance, this case is remarkable in that the IRS was willing to give the issue away without any claim being filed at all, but the Justice Department prevented that. Again, this illustrates an important difference between refund and deficiency litigation.

**Exceptions to the Variance Doctrine**

There are some limited exceptions to the broad rule of variance. Although the rules can vary from circuit to circuit, *Computervision* provides a useful compendium of four principal exceptions.

The first exception to the variance doctrine is for an informal claim. A taxpayer may file an informal claim within the statute of limitations that fairly apprises the IRS of the basis of the claim. The informal claim must have a written component. This doctrine did not apply in *Computervision* because the taxpayer never hinted to the IRS, within the limitations period, that it wanted the benefit of Rev. Rul. 99-40. (Although Rev. Rul. 99-40 was not even issued until after the statute of limitations on Computervision’s refund claim had expired, there were cases stretching back to the 1970s that applied the same principles.)

The informal claim defense saved the day, however, in *Mobil Corp.*,25 a remarkable case illustrating how the way in which the IRS manages large cases interacts with what is an allowable informal claim.

Mobil’s IRS audit cycle was for the 1995–1997 years. On the 1997 return, the year at issue in the refund suit, Mobil claimed an overpayment of tax. Mobil signed Form 872 for 1995 and 1996 (but not 1997), extending the statute of limitations on assess-
Mobil apparently thought that it had until February 28, 2002, which was six months after the expiration of the Form 872 that Mobil had filed for 1995 and 1996, to file a formal refund claim for 1997. In fact, Mobil had only until September 15, 2001, three years after filing its 1997 return.

The Mobil audit plan provided that after June 30, 2000, “the taxpayer should meet with the Case Manager and the [Team] Coordinator to determine if [affirmative claims] can be considered as informal claims, or must they be filed on form 1120-X.” On audit, the IRS disallowed several items on the 1997 return, but because of other adjustments, Mobil was still entitled to a refund for that year. Mobil filed a formal claim (to obtain a larger refund) regarding nine separate items for the 1997 year on February 28, 2002, but the government later denied the claim on the basis that it was too late. Mobil brought a refund suit to contest the disallowance.

In its suit, Mobil argued that it had made valid informal claims within the time allowed. The court agreed as to eight of the nine items, finding that all requirements for an informal claim were met before the statute of limitations ran. First, the IRS had examined the items and was familiar with the facts and grounds that Mobil put forth in defense of its position. Second, the IRS knew that Mobil sought a refund, because Mobil included these on a list of unagreed items submitted by Mobil to the IRS on April 25, 2001. Third, the requirement that the informal claim have a written component was satisfied both by Mobil’s original return (which included the contested items and claimed a refund) and by the list of unagreed items.

On the other hand, for the one remaining item that was not part of the original return and examination, the informal claim doctrine did not apply. Mobil first submitted this item in writing to the IRS on May 10, 2001. As noted above, Mobil’s audit plan specifically provided that claims after June 30, 2000, had to be formal unless otherwise agreed by the Case Manager. The court held that the absence of any evidence of such approval amounted to rejection of the informal claim. Mobil additionally asserted that it had timely discussed its refund claim position on this issue with a specialist working on similar issues for Mobil’s other tax years. However, the court found that, regardless of what conversations may have occurred, this specialist was not authorized to receive a refund claim, and hence the discussions were ineffective to constitute a valid informal claim. In the court’s view, only the Team Manager or the Team Coordinator had that authority.

Note that a taxpayer such as Mobil would never have relied on the informal claim doctrine deliberately, but Mobil was creatively able to use the doctrine to effectively bail itself out in a situation where its formal claim was filed late. It is also remarkable that Mobil was held by the court to the terms of the audit plan, thought of by some taxpayers as insignificant IRS paperwork. The same result might occur under the terms of a LIFE or a CAP examination.

The second exception to the variance doctrine is waiver. If a taxpayer files a formal claim that omits a specific item, the IRS can waive the variance defense if it considers the specific item within the limitations period. This did not apply in Computervision because the government did not consider the claim for application of Rev. Rul. 99-40 to Computervision’s interest computations until after the statute of limitations had expired.

Another way the government can waive variance is by asserting an entirely new basis to deny the refund claim. In Procter & Gamble Co., the taxpayer engaged in an “Advance Payment Transaction” with its FSC. The IRS said that the transaction materially distorted income and made an adjustment. The taxpayer paid the tax that the IRS asserted was due and filed a refund claim that defended against the material distortion argument. At trial in the subsequent refund suit, the government asserted, and prevailed on, the theory that the taxpayer violated the FSC administrative pricing rules. Procter & Gamble then objected on the basis that this was a new ground that it should have been allowed to address by showing the amount it would have been entitled to under the gross receipts administrative pricing rule, which was different from the rule Procter & Gamble had used, and which was not discussed in the refund claim. The court agreed that the government can waive variance by asserting a new ground at trial, but held that it has to be a ground that the taxpayer could not have anticipated.
when it filed the refund claim. The material distortion and administrative pricing theories turned on the same “matching” of income and deductions, so the court held that the taxpayer should have raised the defense to the administrative pricing argument in its refund claim.35

A third exception to the variance doctrine, now probably obsolete, relates to general claims. A taxpayer can file a “general” claim within the limitations period and, if the IRS has not finally rejected it, make it more specific outside the limitations period. A “general” claim only says that there is an overpayment and asks for a refund; it does not specify any grounds. Rarely would anyone file such a claim. This third exception does not apply if the filed claim is specific, rather than general. It did not apply in Computervision because the refund claim was specifically for interest related to the DISC issue. Although Computervision’s claim also asked for a refund based on “such other grounds as are shown to be appropriate by the tax returns, books and records and the Examination Report and related Protest,” that general language was insufficient to make Computervision’s claim a “general” one.

A fourth exception to the variance doctrine is germaneness. If a taxpayer files a specific claim within the limitations period, the taxpayer can raise after the limitations period, but while the IRS still has jurisdiction, a new legal theory that is “germane” to the original claim (i.e., it relates to facts the IRS examined or should have examined). Computervision did not qualify because (i) its claim for application of Rev. Rul. 99-40 involved different facts than DISC qualification, and (ii) it was made after the IRS lost jurisdiction of the claim through the filing of the refund suit.36

This exception was similarly unavailable in Barrick Resources (USA) Inc.37 Barrick incurred NOLs in 1997 and 1998 and timely filed refund claims to carry them back to 1994 and 1995. It realized, after the statute of limitations had run on filing refund claims for the loss years, that some of the losses were from mining reclamation eligible for a 10-year carryback. Barrick then filed refund claims carrying the losses back to 1991 and 1992 and argued that they were amendments of its earlier, timely carryback refund claims. The court rejected this assertion. The new carryback claims were for entirely different years and involved facts (eligibility for the 10-year carryback) that the IRS need not have examined in its consideration of the original, timely refund claims.

However, in Parker Hannifin, supra, the Court of Federal Claims allowed a refund claim under Rev. Rul. 99-40 to be increased from $9,000 (filed before expiration of the statute of limitations) to $3.6 million afterward based on germaneness.

**The Refund Claim Penalty**

The decision to file an income tax refund claim has been considerably complicated by the enactment in 2007 of a penalty38 relating to such claims. Under Code Sec. 6676(a), a 20-percent penalty is imposed on the “excessive amount” of such a claim unless that part of the claim had a “reasonable basis.” The “excessive amount” is the portion of the claim that exceeds the allowable amount. “Reasonable basis” is undefined, but guidance may deem it to be the same as the reasonable basis standard in current Reg. §1.6662-3(b)(3), which states that if:

... a return position is reasonably based on one or more of the authorities set forth in §1.6662-4(d)(3)(iii) [authorities considered in determining whether there is substantial authority] (taking into account the relevance and persuasiveness of the authorities, and subsequent developments), the return position will generally satisfy the reasonable basis standard even though it may not satisfy the substantial authority standard as defined in §1.6662-4(d)(2).

Consider the plight, if it arose today, of a taxpayer having a Rite Aid issue. In the Rite Aid case, the taxpayer took the position that the loss disallowance rules in the consolidated return regulations were invalid. Regulations are, of course, rarely invalidated. In fact, the taxpayer lost on this issue in the Court of Federal Claims. Imagine, then, another taxpayer having the same issue, with the statute of limitations on filing a timely refund claim about to expire, deciding whether to file a claim. At that point in time, the only direct authority (the Court of Federal Claims decision) was adverse. Should the taxpayer risk the 20-percent penalty, or forego the claim? This decision would have to be made, of course, without the knowledge that the Federal Circuit would reverse the lower court’s decision, and that the IRS would ultimately acquiesce.

The situation is complicated by the fact that, unlike many other penalties, there is no exception for “reasonable cause.” If a portion of a refund claim is
denied, the only ground for penalty waiver is that the
denied portion had a reasonable basis. For example, if
a large multinational corporation files a refund claim
that is based in part on erroneous data from one of its
operating divisions, despite having reasonable pro-
cedures in place to identify such errors, there might
be reasonable cause, but the penalty might still be
applicable on the ground that there was not a reason-
able basis under the legal principles involved.

It is also not clear what constitutes a refund claim
for purposes of this penalty. Certainly, a Form 1120X
is subject to it. But what about an informal claim
raised on audit with the examination team? What
about a “protective” claim? One hopes that forthcom-
ing guidance will resolve these issues.

**Properly Reserving the Right to File a Claim**

At the conclusion of an IRS examination, rather than
asking for a statutory notice of deficiency, the tax-
payer could elect to pay the tax with the thought of
filing a timely refund claim some time in the future.
If the taxpayer does this at the examination level, the
taxpayer will ordinarily be asked to sign Form 870.

This form expressly does not preclude filing a sub-
sequent refund claim, and states: “Your consent [to
assessment] will not prevent you from filing a claim
for refund (after you have paid the tax) if you later
believe you are so entitled.”

On the other hand, if the taxpayer does this in IRS
Appeals, the taxpayer will ordinarily be asked to sign
Form 870-AD. In this situation, the taxpayer must make
sure that it preserves the issue for litigation. Form 870-
AD, in contrast to Form 870, states that “[n]o claim
for refund or credit will be filed or prosecuted by the
taxpayer for the years stated on this form, other than
for amounts attributed to carrybacks provided by law.”

Some courts have disregarded this language because
the Form 870-AD is not a closing agreement under
Code Sec. 7121. However, some courts have upheld
the restriction on equitable estoppel grounds. In W.
Whitney, for example, the taxpayers (who resided in
the Ninth Circuit) signed a Form 870-AD conceding
an issue, but a month later the Ninth Circuit decided
the issue in their favor in another case. They filed a
refund claim. The district court held that the claim
was barred by the Form 870-AD; the Ninth Circuit
held that Form 870-AD does not by itself preclude a
refund claim, but remanded to determine if taxpayer
was estopped from raising the claim.

Obviously, a taxpayer would not want to be in a po-

tition where this becomes an issue in its case. Appeals
officers often cooperate in allowing “reservations” as
to specific issues, though the language may have to
be negotiated. Note that Form 870-AD reservations
are necessary but not sufficient to preserve the claim.
Such reservations often expressly provide that they do
not constitute a claim for refund, which must be filed
separately to protect the taxpayer’s interests.

**The Government’s Right to Offset**

Under E.P. Lewis, the taxpayer must prove that there
was an overpayment for the year in order to be en-
titled to a refund. Even if the statute of limitations on
assessment has run, the IRS can bring up new issues
to show that there was not an overpayment. It can do
this to reduce the refund, but cannot assess additional
tax after the statute of limitations runs on assessment.

So, even if a taxpayer that has extended the period of
limitations through Form 872 waits for the six-month
window after the statute of limitations on assessments
has expired to file its claim, it is still subject to offset
to reduce its claimed refund, even though the govern-
m ment may not assess additional tax.

The IRS cannot, however, wait forever to raise the
offset. In Principal Life Ins. Co., the government
waited until after the court had decided the issue
being litigated to raise a new issue as an offset. The
court denied the government permission to do so.

**Refunds vs. Deposits**

During an audit, it is possible for a taxpayer to make
a deposit rather than paying assessed tax. These are
governed by Rev. Proc. 2005-18. Like a tax payment,
a deposit stops the running of interest on a deficiency
from the date that it is made. However, since it is not
an actual tax payment, the taxpayer does not file a
refund claim to recover a deposit. Under Section 6
of Rev. Proc. 2005-18, if the deposit has not been
applied to a tax liability, the taxpayer simply writes
to the IRS and asks for it back. However, the taxpayer
will receive less interest than it would on a refund.

The statute of limitations situation is also different.
For example, if the IRS makes an error in connec-
tion with a deposit, such as paying the taxpayer too
much, the normal two-year period for the govern-
ment to recover erroneous refunds does not apply.
The government has at least six years to recover the
eroneous payment.
When Can a Refund Suit Be Filed?\(^{48}\)

If a properly filed refund claim\(^{49}\) is denied or is not acted on by the IRS, the taxpayer has the right to file suit in a refund forum. There are complicated limits on the time within which such a suit may be filed. Code Sec. 6532(a)(1) states that no refund suit:

... shall be begun before the expiration of 6 months from the date of filing the claim ... unless the Secretary renders a decision thereon within that time, nor after the expiration of 2 years from the date of mailing by certified mail or registered mail by the Secretary to the taxpayer of a notice of the disallowance of the part of the claim to which the suit or proceeding relates.\(^{50}\)

Thus, the first rule is that the taxpayer must wait at least six months to give the IRS the opportunity to consider the claim; however, once the claim has been actually disallowed, the taxpayer can sue even though the six months have not expired. If it is clear that the claim will be disallowed and the taxpayer wants to move ahead to litigation, the taxpayer may request prompt disallowance.

All this is easy enough, but the question sometimes arises as to when the IRS has disallowed a claim. For example, before the taxpayer receives a notice of claim disallowance, IRS will usually propose disallowance in pattern letter 569, the refund claim equivalent of a 30-day letter. This allows the taxpayer to take the disallowance of the claim to Appeals by filing a protest. Several court decisions have held that a 30-day letter terminates the six-month waiting period as it constitutes a decision on the claim.\(^{51}\) In a chief counsel advice, the IRS held that a 30-day letter on Form Letter 569 was not a notice of claim disallowance.\(^{52}\)

With the 30-day letter, the IRS will include Form 2297, Waiver of Statutory Notice of Claim Disallowance. If the taxpayer signs the Form 2297, the taxpayer generally will not receive a statutory notice of claim disallowance. The form starts the two years that the taxpayer has in which to file suit (discussed infra). So, it has the same effect on the two-year rule as receiving a notice of disallowance. Is the Form 2297 therefore also treated as a notice of disallowance to enable the taxpayer to bring suit within six months of filing the claim? No. The form itself states that “[f]iling this waiver within six months from the date the claim was filed will not permit filing of a suit for refund before the six-month period has elapsed unless a decision is made by the Service within that time disallowing the claims.”

There is no reason for a taxpayer to sign a Form 2297 if the taxpayer disagrees with the IRS action. If the taxpayer accidentally does sign the Form 2297 and needs more than the two years afterwards to file suit, the taxpayer can try to get the IRS to enter into an agreement under Form 907, Agreement to Extend the Time to Bring Suit, that will extend the period. As a practical matter, it is sometimes difficult to find someone at the IRS who believes that he has jurisdiction to sign a Form 907.

Some taxpayers take the view that they should be able to file a refund suit before the six months expire, because the actual trial will not take place until after the six months have elapsed. Some courts approve this\(^{53}\) while others do not.\(^{54}\) While the law is quite unclear in this area, a taxpayer can eliminate risk simply by waiting out the six months.

The second rule for filing a refund suit is that the taxpayer must file suit within two years of the notice of disallowance.\(^{55}\) The notice is usually a pattern letter stating, “This letter is your legal notice that we have disallowed your claim.”

In Rev. Rul. 56-381,\(^{56}\) the IRS held that “in the absence of a waiver [Form 2297] filed by the taxpayer of the requirement that he be mailed a registered notice of disallowance, a notification letter rejecting the taxpayer’s claim, not sent by registered mail, will not invoke the two-year period for filing suit, and such period does not commence until action is taken by the Secretary or his delegate in the form of a notice of disallowance of a claim by registered mail.” One would think that this establishes a “bright line,” registered or certified mail, unambiguous letter requirement to start the two years. This is not the case.

In E. Finkelstein,\(^{57}\) the taxpayer received a notice of disallowance that was not sent by registered or certified mail. The taxpayer filed suit more than two years later. She argued that the statute of limitations under Code Sec. 6532(a) never began to run because the IRS did not comply with the registered or certified mail requirement when it sent its notice of disallowance. The court disagreed with the taxpayer.

The requirement of notice by certified mail or registered mail in § 6532 may be characterized
as a protective measure for the I.R.S. to use to prove that the Notice of Disallowance was indeed mailed. The fact that the Notice of Disallowance may not have been mailed by certified or registered mail is of no moment in this case. [Taxpayer’s] actual receipt proves that the Notice of Disallowance was delivered.58

Clearly Rev. Rul. 56-381 did nothing to protect the taxpayer in this case. In TAM 9702002,39 the taxpayer had deficiencies for several years that were reduced by NOL carrybacks reflected in timely refund claims. The IRS made an error unfavorable to the taxpayer in computing interest on the deficiencies as reduced by the carrybacks. The IRS provided the interest computations to the taxpayer, but neither noticed the error. The taxpayer subsequently discovered the mistake and filed suit to recover additional deficiency interest more than two years after receiving the IRS interest computations. The taxpayer argued that the two-year period for it to file suit did not begin to run because the IRS had not mailed a formal notice of claim disallowance by registered or certified mail. The conclusion in the TAM was that “the Service intended to allow the taxpayer’s implicit claim for refund of deficiency interest in part, and it notified the taxpayer of that fact—at the latest—when it refunded the interest.” That is, the computations functioned as the statutory notice of claim disallowance. The IRS held that the taxpayer should have filed suit within two years after receiving the computations.

In R.G. Rosser,60 the taxpayer filed refund claims for a number of tax years. The IRS mailed the taxpayer notices of disallowance of the claims for each of the years at issue by certified mail. The taxpayer alleged that he never received the notices of disallowance. Three years after the notices were mailed, the taxpayer filed suit seeking refunds for the years at issue. The government submitted evidence that it had mailed the notices of disallowance and moved for summary judgment on the basis that the taxpayer’s suit was barred by the statute of limitations under Code Sec. 6532(a) because more than two years had passed since the mailing. The Court of Appeals said: “[T]he statutory period for bringing suit begins to run from the date that the IRS mails, by certified or registered mail, a notice of disallowance to the taxpayer, regardless of whether the taxpayer actually receives the notice.”61

However, in J.B. Thomas,62 the court held that a claim disallowance notice not sent by certified or registered mail did not start the two years.

So, in the view of the IRS and at least some courts, the two-year period within which to bring suit can start (i) even though the letter was not sent by certified or registered mail; (ii) even though it was never sent, if the taxpayer should have realized that the IRS had denied part of its claim; or (iii) even though it was sent, but the taxpayer never received it.63

Several cases64 have held that once a claim is disallowed, a refund suit may not be brought on a second, identical claim after the two-year period for filing suit on the original claim has expired, even if the second claim is otherwise timely. So, suit must be filed within two years of the first, disallowed claim.

In the case of TEFRA audits of pass-through entities, a somewhat different set of rules applies. The equivalent of a refund claim in a TEFRA audit is an Administrative Adjustment Request (AAR) under Code Sec. 6227 on Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request. This generally must be filed within three years after filing the return;65 the period may be extended.66 There is no two-year rule here because passthrough entities do not pay tax. The “window” for filing a refund suit under Code Sec. 6228 is six months to two years after filing the AAR (not two years after AAR disallowance).66

**Conclusion**

As the foregoing illustrates, refund claims can be complicated indeed. Even very large and sophisticated taxpayers—in some instances because of their very size and complexity—can encounter unexpected problems. Many problems can be avoided by giving refund claims careful attention from the start or through exploration of exceptions such as Mobil’s use of the informal claim doctrine.

Some important issues are still particularly thorny, however, such as the calculus going into whether to file a refund claim in light of the new Code Sec. 6676 penalty, and if so, how conservative the claim must be to avoid the penalty’s assertion. No amount of care will remove these risks.
This article is not intended to be a compendium of all possible refund claim problems, but will focus primarily on the interesting issues posed by these large taxpayers. To round out the analytical framework, some other cases will also be mentioned.

Under Code Sec. 6511(b), the amount that may be refunded is limited to the amount of tax paid or deemed paid during that period. When the three-year period (as extended) applies, the refund claim can usually be for all taxes that were paid for that taxable year.


Id., at 1360.


Note that Form 1139, the taxpayer must file a timely Form 1139, the taxpayer must file a timely Form 1120X to protect its rights.

See Reg. §§1.1502-77a(i)(2), (4) and (f), Example 2.


The unusually accelerated chronology was as follows: The Court of Federal Claims decided Coltec October 29, 2004; Browning- Ferris paid the tax April 25, 2005; Browning-Ferris filed refund claims May 5, 2005; the IRS disallowed the claims May 10, 2005; Browning-Ferris filed suit July 8, 2005; and the Federal Circuit reversed Coltec July 12, 2006. The taxpayer thus still had until April 25, 2007 (two years after paying the tax) to file a valid refund claim.

Reg. §301.6402-2(b)(1).

The author is aware that practice in this area can vary widely. Some practitioners include everything they can think of in refund claims, with voluminous attachments, lest the government argue that some material fact or ground was left out. Others treat the claim as if they were filing a complaint in a lawsuit, laying out only the major facts and grounds. The author does not intend to imply that the latter practice is necessarily inadequate, but disputes over whether a claim is sufficient may be avoided with a more extensive presentation.

Lockheed Martin Corp., CA-FC, 2000-1 USTC ¶50,401, 210 F3d 1366.


Domino Sugar Corp., CA-2, 2004-1 USTC ¶50,155, 349 F3d 84. The case involved the government’s effort to recover interest erroneously paid on a deposit. In the district court proceedings, Tate & Lyle N. American Sugars, Inc., DC-NY, 2002-2 USTC ¶50,676, 228 FSupp2d 308, the taxpayer argued that the payment it had made was not a deposit, which found some support in the ambiguous way the IRS had coded the payment. The court nevertheless found that a deposit had
been intended and that the interest had to be returned, because at the time, returned deposits did not bear interest.

Although this discussion does not itself involve citation to cases involving large corporate taxpayers, the author has found that such taxpayers often require advice on these issues.

Code Sec. 7422 states that no refund suit may be maintained unless a refund claim was duly filed.

Emphasis added.

See, e.g., Register Publ'g Co., DC-CT, 61-1 ustc ¶9246, 189 FSupp 626; W.R. Stephens, DC-AR, 63-2 ustc ¶12,163, 216 FSupp 854; E.E. Hicks, DC-MO, 64-2 ustc ¶12,249. Block-Southland Sportswear Co., DC-NC, 73-1 ustc ¶9520, aff'd per curiam, CA-4, 73-2 ustc ¶9552, 480 F2d 921, held that a 30-day letter did not terminate the six-month period because it did not make any reference to the taxpayer's refund claim or the consideration or disallowance of such claim.

CCA 200444019 (June 24, 2004). (“We believe that such a letter does not qualify as a notice of claim disallowance. Rather than informing the Taxpayer that it may file suit in the United States District Court or United States Court of Federal Claims, the letter suggests that the taxpayer could contact the Service to discuss the proposed disallowance. We believe that such a letter is too equivocal and uncertain to qualify as a notice of claim disallowance.”)

Sumser, Brion v. IRS Dist. Dir., DC-VA, 2001-1 ustc ¶50,222.

M.D. Smith, DC-WA, 99-1 ustc ¶50,291.

The IRS determined that it can reconsider and settle a refund claim even after sending a statutory notice of claim disallowance, but that this action does not extend the two-year period for filing suit. CCA 200828028 (Mar. 10, 2008). However, note that in this situation, the taxpayer and the IRS could agree on Form 907, discussed above, to extend the time within which to bring suit.

Rev. Rul. 56-381, 1956-2 CB 953.


Id., at 430.

TAM 9702002 (Jan. 10, 1997).

R.G. Rosser, CA-11, 94-1 ustc ¶50,002, 9 F3d 1519.

Id., at 1522.

J.B. Thomas, CA-6, 99-1 ustc ¶50,222, 166 F3d 825.

The author is aware of at least one very large taxpayer that has a policy to consider bringing suit within two years after the refund claim is filed, out of concern that the disallowance notice might have been received but misdirected within the corporation.

E.g., R. Pransky, CA-3, 2003-1 ustc ¶50,216, 318 F3d 536; B.A. Stratmore, CA-3, 72-2 ustc ¶9476, 463 F2d 1195; G. Jones, ClsCt, 92-2 ustc ¶50,468, 26 ClsCt 424.

Code Sec. 6227(a).

Code Sec. 6227(b).

This period may be extended on Form 9248 (Agreement to Extend the Time to File a Petition For Adjustment by the Tax Matters Partner (Person With Respect to Partnership or Subchapter S Items). Code Sec. 6228(a)(2).

This article is reprinted with the publisher's permission from the JOURNAL OF TAX PRACTICE & PROCEDURE, a bi-monthly journal published by CCH, a Wolters Kluwer business. Copying or distribution without the publisher's permission is prohibited. To subscribe to the JOURNAL OF TAX PRACTICE & PROCEDURE or other CCH Journals please call 800-449-8114 or visit www.CCHGroup.com. All views expressed in the articles and columns are those of the author and not necessarily those of CCH.