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IRS Insights
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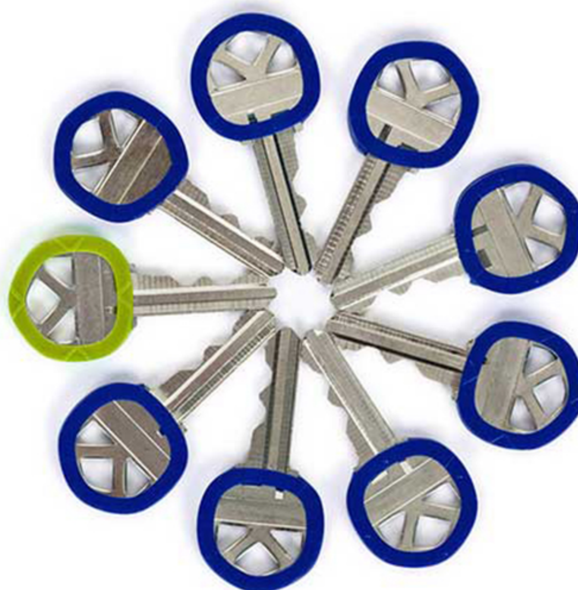

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CCA memo on meaning of "attributable to" in 6511(d)(2)

The IRS Office of Chief Counsel recently released a memorandum that considered the application of the statute of limitations provided in Section 6511(d)(2) in the context of a refund claim arising from the cascading effects of a net operating loss (NOL).[1] Specifically, the memorandum considered whether a refund claim was within the period of limitations allowed under Section 6511(d)(2)(A) as "overpayment attributable to [an NOL] carryback" as provided by the statute.

The refund arose as a result of a settlement agreement that provided that certain amounts paid by the taxpayer qualified as a product-liability specified liability loss under Section 172 that could be carried back ten years.[2] The taxpayer filed an amended return carrying back the loss. This NOL carryback triggered an alternative minimum tax

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[1] CCA 202023006 (March 6, 2020)
[2] *See* IRC §172(b)(1)(C); §172(f)(1)(A)

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(AMT) liability, which the Taxpayer paid. This generated a minimum tax credit (MTC) that the taxpayer carried forward, resulting in the overpayment that was the subject of the refund claim at issue.

The memorandum addressed whether a refund claim should be considered timely under Section 6511(d)(2) where it arises from an NOL carryback that triggered a MTC. Section 6511 provides the limitations periods for refunds.[3] Section 6511(d)(2) provides a special limitations period for claims for credit or refunds relating to net operating losses or capital loss carrybacks. The subsection states that for such claims "attributable to" an NOL carryback, an extended period shall be provided in lieu of the general three-year limitations period set forth in Section 6511(a).[4] Generally, this extended period is three years after the return due date for the year in which the NOL arose. The question addressed by the Office of Chief Counsel in the memorandum was whether the taxpayer's overpayment, resulting from the MTC, was "attributable to" the NOL carryback within the meaning of Section 6511(d)(2)(A).

At the outset, the memorandum recognizes that the meaning of the phrase "attribute to" has been subject to "inconsistent interpretations for many years." Chief Counsel identifies three main interpretations of the "attributable to" in the context of a NOL or capital loss carryback:

1. Immediate cause of the overpayment;
2. Traceable to the NOL or capital loss; or
3. Originating cause of the refund.

As neither the Internal Revenue Code nor the Treasury Regulations define how "attributable to" should be interpreted, Chief Counsel's analysis begins with an examination of relevant caselaw and notes that "[o]nly one case has squarely addressed the question of whether, under Section 6511(d)(2), an overpayment 'attributable to' an NOL carryback that frees up a credit that is carried to another year and creates the overpayment."[5]. The district court in *Marshalltown*, in an opinion that contains no analysis, in effect, utilized an original cause of the refund theory to hold that an overpayment from an Investment Tax Credit, freed up by an NOL carryback, was "attributable to" the NOL carryback for purposes of Section 6511(d)(2). As a result, Chief Counsel analyzed caselaw that interpreted the term "attributable to" in similar provisions within Section 6511 and under the parallel deficiency provisions of Section 6501 and found support for applying the originating cause interpretation of "attributable to" in the context of Section 6511(d)(2).[6]

In addition, the memorandum finds support for the originating cause view in a textual analysis of the term "attributable to." Citing the Seventh Circuit Court of Appeals' reasoning in *First Chicago*, which found that the meaning of phrase "attributable to" should be consistent with the same phrase in Section 6501(h) and apply to refunds resulting from tax attributes' downstream effects. In *First Chicago*, the Seventh Circuit also cited the legislative history of the 1945 Act to support reading the "attributable to" phrase in Section 6501(h) and Section 6511(d)(2) consistently and determined that it should apply to overpayments that can be traced to a tax attribute other than the immediate cause of the overpayment

The Office of Chief Counsel analysis also plumbed the legislative history of Section 6511(d)(2) finding additional support for the originating cause interpretive view of "attributable to." The memorandum points to a House Committee report on the Act that introduced the predecessor of Section 6511(d)(2) and noted that it shows that Congress intended the words "attributable to" to encompass not only claims relating directly to the carryback year but also to claims relating to other years to which a freed-up credit from the carryback year was carried.[7] The memo explains that an overpayment is attributable to unused excess profit credits not only if they directly relate to the carryback year but also other years in which a credit was freed as a result of the carryback. After exploring the legislative history of the provision of Section 6511(d)(2) and the legislative evidence for the meaning of the parallel phrase, "attributable to" in Section 6501(h), the memorandum concludes that the legislative history favors the originating cause interpretation.

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[3] *See* IRC §6511
[4] *See* IRC §6511(d)(2)(A)
[5] *Marshalltown Savings and Loan Assn. v. United States*, 92-1 USTC ¶50,100 (S.D. Iowa 1991)
[6] *Trusted Media Brands, Inc. v. United States*, 2017-2 USTC ¶50,359 (S.D.N.Y. 2017), *aff'd*, 899 F.3d 175 (2d Cir. 2018); *First Chicago Corp. v. Commissioner*, 742 F.2d 1102 (7th Cir. 1984); *Herman Bennett Co. v. Commissioner*, 65 T.C. 506 (1975)
[7] Tax Adjustment Act of 1945, P.L. 79-172

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Based on their survey of the caselaw, textual analysis and legislative history, the Office of Chief Counsel concludes that the preponderance of evidence favored the originating cause interpretation of the phrase "attributable to." Therefore, the taxpayer's overpayment resulting from the MTC was attributable to the NOL for purposes of Section 6511(d)(2) and, thus, the refund claim was timely.

CCA Memorandum Addresses the Effect of Superseding Returns on the Statute of Limitations in Sections 6501 and 6511

In a recently released non-precedential Chief Counsel Advice (CCA) Memorandum[8] the Internal Revenue Service (IRS) considered whether a superseding return[9] constitutes "the return" for purposes of starting the assessment and refund statute of limitations in sections 6501 and 6511. The CCA concludes that the original return, not the superseding return, is "the return" that starts both the assessment and refund statutes of limitations, relying on the reasoning of the Supreme Court in *Zellerbach Paper Co. v. Helvering*, to support its conclusion.[10]

Background

Section 6501(a) provides that the IRS may assess additional tax for a given tax year within three years after "the return" for that year was filed.[11] Under section 6511(a), a taxpayer must file a claim for refund of any tax within three years from the time "the return" was filed or two years from the time the tax was paid, whichever expires later.[12] In both sections the phrase "the return" is not defined, creating a purported ambiguity about which return counts as "the return" in situations where a taxpayer files a superseding return on or before the due date (including valid extensions).

Analysis

The CCA begins its analysis by examining *Zellerbach Paper Co. v. Helvering*, and *National Paper Products Co. v. Helvering*. [13] Both cases arose from similar facts: a new tax statute was enacted after the company had timely filed its tax return, and each statute had a retroactive effect. In *National Paper*, the taxpayer filed an additional return as a supplement to the original one; in *Zellerbach*, the taxpayer did not. In both cases, the IRS issued a notice of deficiency after the period of limitations for assessment, based on the filing date of the original return had expired. In each case, the government argued that the original return was a nullity because it did not incorporate the new tax statute and therefore, the period of limitations for assessment had not begun to run. In both cases, the Supreme Court concluded that the returns qualified as valid returns and the period of limitations began with the filing of the original returns, making the notices of deficiency untimely.

Instrumental in the CCA's analysis is the Court's reasoning in *Zellerbach*, which held a second return, supplementing the original return by reporting additional tax, did not toll the assessment statute of limitations. The CCA determines that this reasoning can be applied more broadly to situations where an amended or superseding return is filed. The memorandum cites *Badaracco v. Commissioner*[14] as another precedent that provides a similar theory about what constitutes an original return for purposes of the relevant period of limitations. In *Badaracco*, the Supreme Court held that a non-fraudulent amended return that was filed after a fraudulent return could not replace the indefinite assessment limitations period for a fraudulent return with the general three-year assessment limitations period. The CCA focuses on the Court's reasoning that the original return, despite its defects, was still a return within the meaning of the statute of limitations and therefore, filing an amended return did not start a new period of limitations.

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[8] Chief Counsel Advice Memorandum 202026002 (Release Date: 6/26/2020)
[9] A superseding return is a subsequent tax return filed after an initial tax return, but within the tax return filing period (including extensions.) *See* IRM 3.5.61.1.3. which explains that a tax return filed prior to the due date and changing the data reported on the original return is a type of return that is commonly referred to as a "superseding" return.
[10] *Zellerbach Paper Co. v. Helvering*, 293 U.S. 172 (1934)
[11] *See* IRC §6501(a)
[12] *See* IRC §6511(a)
[13] *National Paper Products Co. v. Helvering*, 293 U.S. 183 (1934)
[14] *Badaracco v. Commissioner*, 464 U.S. 386 (1984)

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The CCA concludes that this line of reasoning applies with equal force to superseding returns because nothing in *Zellerbach* limits its holding to amended returns and the Court did not differentiate between amended and superseding returns. In addition, the CCA explains that it would be unfair to taxpayers to conclude otherwise and allow a second return to restart the assessment statute of limitations.

As to the seemingly contradictory precedent of *Haggar Co. v. Helvering*,[15] the CCA takes the position that *Haggar* does not require a different view of what constitutes an original return. In *Haggar*, the taxpayer was required by statute to declare the value of stock on the "first return." The statute provided the declaration could not be amended. The taxpayer, after realizing that he had mistakenly reported the par value of the stock, filed a superseding return declaring the actual value. The Commissioner refused to accept the superseding return because it was not the "first return." The Court disagreed, finding that the first return in the statute meant the return in the first year in which the taxpayer exercised the privilege of determining the stock value for tax purposes; in contrast to returns in subsequent years. While acknowledging that *Haggar* has come to stand for the proposition that superseding returns, whether filed prior to the original or extended due date, are effective for most purposes, including elections and penalties calculations, the CCA concludes that *Haggar* does not compel the conclusion that a superseding return is the return for statute of limitations purposes. Thus, in the CCA's view, "a superseding return can be effective in modifying the original return by relating back to and becoming part of the original return, under *Haggar*, without tolling the period of limitations for claims for refund, in line with *Zellerbach*."

Although not addressed in the CCA, the IRS had reached a contrary conclusion in two prior advice memoranda. In CCA 200645019[16] the IRS addressed the question of whether the filing of an original Form 1120 or the subsequent filing on September 15, 2003 of a second Form 1120, which is within the extended due date for the return and includes new information for the same taxable year, started the three-year statute of limitations on assessment under section 6501. In CCA 200645019, the IRS stated:

> Based on the same rationale discussed in section one above, an extension of time to file a return is taken into account in determining what return is "the return" for purposes of starting the statute of limitations. Consequently, we conclude that the valid return filed on September 15, 2003, the extended due date, is the return of the taxpayer and starts the statute of limitations on assessment under section 6501.

In Service Center Advice 1998024, which addressed the effect of a timely amended return (which is identified in the document to be a superseding return) on the assessment statute of limitations, the IRS stated:

> Under a line of cases, rulings, and regulations exemplified by *Haggar Co. v. Helvering*, 308 U.S. 389, 60 S. Ct. 337, 84 L. Ed. 340, 1940-1 C.B. 237 (1940), a timely amended return is generally treated as the taxpayer's return for most purposes. There is no persuasive reason to depart from that rule in the statute of limitations context. A second line of authority, to the effect that a late amended return is a nullity, see, *e.g.*, *Badaracco v. Commissioner*, 464 U.S. 386, 104 S. Ct. 756, 78 L. Ed. 2d 549 (1984), is distinguishable.

Conclusion

Based on this analysis of the caselaw, the CCA concludes that the statute of limitations periods in sections 6501 and 6511 begin with the filing of the first return rather than the superseding return. Taxpayers that file superseding returns should consider filing any refund claims within three years of the filing of the initial return if their refund statute of limitations is not otherwise extended.

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[15] *Haggar Co. v. Helvering*, 308 U.S. 389, (1940)
[16] Chief Counsel Advice Memoranda 200645019 (released 6/20/2006)

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The Tax Court Addresses the Application the Substantial Omission of Gross Income Exception to the Ordinary Three-Year Period of Limitations on Assessment

In *ACQIS Technology, Inc. and Consolidated Subsidiaries v. Commissioner*,[17] the Tax Court addressed whether the substantial omission of gross income exception to the ordinary three-year period of limitations on assessment applied where the taxpayer reported patent liability settlement payments as if they were the proceeds of sales of stock. The court held that, if the government's view of the transactions were to be sustained, the disclosures were inadequate. However, the court concluded that it could not determine that the substantial omission of gross income exception applied because the court first needed to decide whether the transactions were properly reported on the relevant returns.

Background

In 2009, ACQIS Technology, Inc. (Taxpayer) filed patent infringement lawsuits against eleven companies.[18] Eight of the defendants entered into settlement agreements that provided for a release of claims and a license of the patents at issue. Taxpayer reported the settlement amounts that it received with respect to these defendants as ordinary income.[19]

Taxpayer also entered into settlement agreements with the other three defendants, but these settlements were structured and reported differently. In those cases, the defendants agreed to purchase stock in Taxpayer as part of the settlement agreement.[20] Taxpayer received the settlement payment amounts in these cases in 2010, 2011, and 2012. However, Taxpayer did not report the settlement payment amounts as income in 2010, 2011, and 2012.[21] Instead, Taxpayer reported as "other costs" on Schedule A, *Cost of Goods Sold*, of $12.1 million, $10.4 million, and $12.7 million on its 2010, 2011, and 2012 returns, respectively.[22] Taxpayer also reported an increase in common stock on Schedule L, *Balance Sheet Per Books*, of $30 million, $8 million, and $33.8 million on its 2010, 2011, and 2012 returns, respectively.[23]

The IRS subsequently determined that the settlement payment amounts should be treated as payments made to settle the patent litigation or, alternatively, that the purported stock purchases lacked economic substance and issued notices of deficiency for the three years.[24] The IRS issued the notices of deficiency more than three years, but less than six years, after the filing of Taxpayer's 2010, 2011, and 2012 returns.[25]

The substantial omission of gross income omission exception to the three-year period of limitations on assessment

Subject to various exceptions, the IRS is required to assess the tax due, or issue a notice of deficiency to the taxpayer, within three years of the date that a return is deemed filed.[26] Section 6501(e)(1)(A) provides an exception to the general rule if the gross income omitted from the return exceeds 25% of the amount of gross income reported on the return (a "substantial omission of gross income). If there is a substantial omission of gross income on the return, the IRS may issue a notice of deficiency within six years of the date that a return is deemed filed (the "substantial omission of gross income exception).[27] However, the substantial omission of gross income exception does

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[17] T.C. Memo. 2020-38.
[18] *See id.*, Slip Op. at *3.
[19] *See id.*
[20] *See id.*, Slip Op. at *4 – *5.
[21] *See id.*, Slip Op. at *5 – *9.
[22] *See id.*
[23] See id.
[24] See id., Slip Op. at *9, *17 n.9.
[25] See id.
[26] See IRC § 6501(a).
[27] *See* IRC § 6501(e)(1)(A).

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not apply to the extent that the taxpayer discloses the omitted gross income "in the return, or in a statement attached to the return, in a manner adequate to appraise the Secretary of the nature and amount of such item."[28]

Under the Tax Court's precedents, a disclosure is adequate if the disclosure is sufficiently detailed to alert the IRS of the nature of the transaction so that the IRS's decision as to whether to select the return for examination is a reasonably informed decision.[29] Conversely, disclosure is inadequate if the IRS needs to thoroughly scrutinize the return to ascertain whether gross income was omitted.[30]

In this case, the parties agreed that that the notices of deficiency were issued more than three years, but less than six years, after the filing of the respective returns. Thus, the issue before the court was whether the Taxpayer adequately disclosed the nature and amount of the omitted income on its tax return for purposes of avoiding the substantial omission of gross income exception to the three-year period of limitations on assessment.

Taxpayer's motion for summary judgment

Taxpayer, in its motion for summary judgment, argued that it adequately disclosed the amount and nature of the settlement payment amounts. Taxpayer further argued that its disclosure was similar to the disclosure of the taxpayer in *University Country Club, Inc v, Commissioner*,[31] where a taxpayer sold country club memberships and reported the membership payment amounts as stock purchases. In that case, the Tax Court held that the taxpayer's disclosure was adequate and, therefore, the six-year period of limitations did not apply.[32]

The Tax Court, however, disagreed with Taxpayer's characterization of the sufficiency of its disclosure and, therefore, denied Taxpayer's motion for summary judgment. The court noted that, if either of the IRS's theories is correct – *i.e.*, that the settlement payment amounts were payments made to settle the patent litigation or that the stock purchases lacked economic substance – Taxpayer's disclosure would not have alerted the IRS as to the nature and amount of the omitted gross income.[33] The court distinguished the disclosure in this case from the disclosure in *University Country Club* because taxpayer in that case attached a statement to its return that included an itemized schedule that reconciled the capital surplus account and disclosed crucial, itemized information about the memberships sold. This detailed information alerted the IRS that the payments may be licenses. By contrast, here, Taxpayer did not attach an itemized statement that disclosed the nature and amount of the settlement payment amounts.[34]

The IRS's motion for summary judgment

The IRS, in its motion for partial summary judgment, argued that the disclosure was plainly inadequate because the disclosure failed to alert the IRS of the true nature and amount of the settlement payments.[35] The court, however, rejected this argument because the adequacy of the disclosure depends on whether the court agreed with the Taxpayer or the IRS regarding the true nature of the transactions. As the underlying characterization of the transactions was not currently before the court, the court concluded that it would be premature for it to issue summary judgment to the IRS on whether the disclosure was adequate to exclude the settlement payment amounts from gross income for purposes of excluding those amounts from the substantial omission of gross income exception computation.[36]

Conclusion

This case highlights the need for taxpayers to consider whether their return positions are adequately disclosed for purposes of avoiding the substantial omission of gross income exception to the three-year period of limitations on

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[28] IRC § 6501(e)(1)(B)(iii).
[29] *See ACQIS Tech.*, T.C. Memo. 2020-38, Slip Op. at *13 (citing *Estate of Fry v. Comm'r*, 88 T.C. 1020, 1023 (1987)).
[30] *See id.*, Slip Op. at *13 (citing *CNT Inv'rs v. Comm'r*, 144 T.C. 161, 214 (2015)).
[31] 64 T.C. 460 (1975).
[32] *See ACQIS Tech.*, T.C. Memo. 2020-38, Slip Op. at *18 (citing *Univ. Country Club*, 64 T.C. at 469, 471)).
[33] *See id.*, Slip Op. at *17 n.9.
[34] *See id.*, Slip Op. at *19.
[35] *See id.*, Slip Op. at *17.
[36] *See id.*

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assessment. Inadequately describing the nature of the transaction can result in a court finding that the disclosure was inadequate and that, therefore, the substantial omission of gross income exception applies.

Howe v CIR: Taxpayer Cannot Equitably Estop Govt With Form 870-AD

In *MacVaugh-Howe v Commissioner of Internal Revenue*,[37] the Tax Court held that the taxpayer could not equitably estop the government from issuing a notice of deficiency after executing a Form 870-AD settlement agreement, finding that the taxpayer did not meet the heightened standard to equitably estop government action.

Background

The case arose out of an examination of a taxpayer who received funds from a C-corporation for which he was the CEO and majority shareholder. The taxpayer used the funds to make investments through a limited partnership owned by his family's trust. During the course of the examination, the taxpayer characterized the transfers as loans. During the examination, books and records of the corporation were provided to the Revenue Agent that evidenced that the amounts received by the taxpayer were treated as loans. Ultimately, the Revenue Agent disallowed the deduction for the loans because they did not meet the "at-risk" rules of section 465.

Relying on *Van Wyk v. Commissioner*, the Revenue Agent issued a Notice of Proposed Adjustment (NOPA), denying the taxpayer's claimed loss deduction for violating the "at-risk" rules.[38] In response, the taxpayer filed a protest to the IRS Office of Appeals. An Appeals Officer reviewed the case and held a meeting with taxpayer's counsel. Taxpayer's counsel and Appeals came to an agreement, executing a Form 870-AD, *Offer to Waive Restrictions on Assessment and Collection of Tax Deficiency and to Accept Overassessment*, that reduced the taxpayer's deficiency and eliminated an accuracy related penalty.

The Form 870-AD stated that the case would not be reopened by the Commissioner unless there were specific occurrences including "fraud, malfeasance, concealment or misrepresentation of a material fact." Afterward, the Appeals Officer memorialized the settlement agreement in an Appeals Case Memorandum (ACM) that detailed that, during the conference, Taxpayer changed its position arguing that the amounts that taxpayer received were not actual bona fide loans. After reviewing the ACM, the Revenue Agent filed a dissent to the Appeals decision on the grounds that the taxpayer had made a material misrepresentation of fact requesting that the taxpayer's case be reopened pursuant to IRS policy.[39] The Appeals Director for Field Operations approved the reopening and the taxpayer was issued notice of deficiency.

Law and Analysis

Taxpayer challenged the validity of the notice of deficiency arguing that the IRS was equitably estopped from reopening the case after having executed the Form 870-AD settling the case. The Tax Court first addressed the taxpayer's argument that the notice of deficiency was invalid. Section 7522(a) requires that a notice of deficiency must describe the basis for, and identify the amount of tax due, interest, additional amounts, additions to tax and assessable penalties included in such notice.[40] The taxpayer contended that the notice of deficiency was invalid because it asserted that the IRS deviated from internal policies in reopening the audit. The Tax Court dispatched this argument by noting that the court will not generally look behind a notice of deficiency to determine its validity unless there is substantial evidence of unconstitutional conduct.[41]

Next, the Tax Court considered taxpayer's argument that the IRS should be equitably estopped from reopening the case and assessing additional tax. The Tax Court reviewed the traditional elements of equitable estoppel as well as the

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[37] *Howe v. Commissioner*, T.C. Memo 2020-78 (June 8, 2020)
[38] *Van Wyk v. Commissioner*, 113 T.C. 440 (1999)
[39] *See* Internal Revenue Manual (IRM) 1.2.17.1.3(2) (Jan. 5, 2007)
[40] *See* IRC §7522(a)
[41] *Greenberg's Express, Inc. v. Commissioner*, 62 T.C. 324, 327 (1974).

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heightened standard that must be met for a party to equitably estop government action. The elements of traditional equitable estoppel are:

1. The party to be estopped must know the facts;
2. The party must have intended that its conduct shall be acted on;
3. The party seeking estoppel must be ignorant of the true facts; and
4. The party seeking estoppel must detrimentally rely on the former party's conduct.

In addition to showing these elements, a party seeking equitable estoppel against the Government must show that:

1. The government engaged in affirmative misconduct going beyond negligence;
2. The government's wrongful conduct will cause serious injustice; and
3. The public interest will not suffer undue damage from the estoppel.[42]

The Tax Court found that the taxpayer could not meet any of the additional elements required for a party to equitably estop the government. Specifically, the Tax Court concluded that the IRS did not engage in any active misrepresentations because the taxpayer was aware of the terms for reopening a Form 870-AD agreement. Furthermore, the Tax Court reasoned that there was no detrimental reliance on the part of the taxpayer because paying a tax deficiency does not constitute detrimental reliance. Accordingly, the Tax Court held that the notice of deficiency was validly issued by the Internal Revenue Service.

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[42] *Purcell v. United States*, 1 F.3d 932, 939 (9th Cir. 1993).

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