DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

March 23, 2001

OFFICE OF
CHIEF COUNSEL

Number: **200125060**
Release Date: 6/22/2001
TL-N-2526-00/CC:CORP:B6
UILC: 1502.77-00, 6402.05-03

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL, CC:LM:RFP:

Attention:

FROM: Jasper L. Cummings, Jr.
Associate Chief Counsel CC:CORP

SUBJECT: Insolvent Subsidiary Member of Consolidated Group Seeking a Refund

This Field Service Advice responds to your memorandum dated December 21, 2000 and supplements and clarifies the Field Service Advice issued to you on September 15, 2000 (the "Prior FSA"), which responded to your memorandum dated June 19, 2000. The Prior FSA is hereby incorporated by reference. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

DISCLOSURE STATEMENT

Field Service Advice is Chief Counsel Advice and is open to public inspection pursuant to the provisions of section 6110(i). The provisions of section 6110 require the Service to remove taxpayer identifying information and provide the taxpayer with notice of intention to disclose before it is made available for public inspection. Sec. 6110(c) and (i). Section 6110(i)(3)(B) also authorizes the Service to delete information from Field Service Advice that is protected from disclosure under 5 U.S.C. § 552 (b) and (c) before the document is provided to the taxpayer with notice of intention to disclose. Only the National Office function issuing the Field Service Advice is authorized to make such deletions and to make the redacted document available for public inspection. **Accordingly, the Examination, Appeals, or Counsel recipient of this document may not provide a copy of this unredacted document to the taxpayer or their representative.** The recipient of this document may share this unredacted document only with those persons whose

official tax administration duties with respect to the case and the issues discussed in the document require inspection or disclosure of the Field Service Advice.

LEGEND

Parent	=
Sub 1	=
Sub 2	=
State X	=
$B	=
$C	=
$D	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Year 5	=
Month B	=

ISSUES

Should the Service disallow a claim for refund on the grounds that the Service cannot determine which member of a consolidated group is entitled to the refund?

CONCLUSIONS

Because the Service will not be able to determine, under existing law, which person made the overpayment for purposes of issuing a refund under IRC § 6402, the Service should disallow a request by any member of the consolidated group for a refund.

FACTS

Parent is the common parent of the Parent consolidated group. Parent is a holding company and purportedly has little or no assets beyond the stock it holds in two

subsidiaries, Sub 1, and a defunct company, Sub 2. All of the three affiliated corporations were incorporated in State X.

The three affiliated corporations filed consolidated returns for the Year 1 through Year 3 (tax years). According to the revenue agent, Year 1 was the first year for which consolidated returns were filed for the affiliated group.

Receivership

In Month B of Year 5, Sub 1 was insolvent and placed in receivership in State X. We are not certain when Sub 2 became defunct. Parent continues to exist as a State X corporation. Despite having the responsibility for filing the consolidated return, Parent has failed to file the Parent consolidated group return for tax years Year 4 and Year 5. At the time of our Prior FSA, the three affiliated corporations had not filed a tax return (neither consolidated nor separate returns) for Year 4 or Year 5.[1]

Before the Prior FSA, the state-court-appointed receiver, pursuant to his duties, intended to file the Year 4 and Year 5 returns on behalf of Sub 1. The receiver knew that only consolidated returns could be filed.[2] Treas. Reg. § 1.1502-77 provides that the common parent can file a consolidated return on behalf of the members of a consolidated group.

Initial National Office and Associate Area Counsel Advice (Before the "Prior FSA")

Pursuant to the last sentence of Treasury Regulation § 1.1502-77(a), the District Director ("Director") sent a letter to Parent informing the sole officer in his capacity as representative of Parent that, with regard to the consolidated liability for Year 4 and Year 5, the Director was breaking the agency relationship between Parent and Sub 1 with regard to these two tax years. Parent was thus notified that the Service

[1]It is our understanding that Sub 1 has filed a consolidated return for Year 4 and Year 5. We note that these would be consolidated returns filed on its own behalf and no other member of the group.

[2]Under the consolidated return regulations, once an affiliated group files a consolidated return, the group must thereafter continue filing consolidated returns unless the group deconsolidates or it obtains the Service's permission to stop filing consolidated returns. In the instant, neither condition is present.

would then be dealing directly with Sub 1 as to its consolidated tax liability for these tax years.[3]

A second letter was sent to the receiver, informing him that, with respect to Year 4 and Year 5, the Director would no longer recognize the agency relationship of Parent with Sub 1. No action was taken with respect to breaking Parent's agency with the defunct subsidiary. The Service informed the receiver, that once the agency relationship between the common parent and that subsidiary was broken, Sub 1 could act for itself in signing a consolidated return. However, the Service emphasized that given the fact that the return would be filed by Sub 1 only on its own behalf, not on behalf of the consolidated group, Sub 1 lacked the authority to act for any other member. The Service also notified the receiver that, pursuant to IRC § 6012(b)(3), the return filed by Sub 1 must be executed by its receiver.

The receiver prepared the Year 4 and Year 5 consolidated returns.

Additional Facts After the Year 4 and Year 5 Returns Were Prepared

After the Director sent the letter breaking agency for Year 4 and Year 5, the Receiver's counsel contacted the Associate Area Counsel again indicating that not only did the receiver want to file the original returns for Year 4 and Year 5, but the receiver wanted to file amended returns for the years Year 1 through Year 3. According to the accountants for the receiver, the Year 5 consolidated return prepared by Sub 1 will result in a loss that will be carried back to those earlier tax years. The attorneys for the receiver stated that the Year 1 amended return would reflect an additional tax liability of approximately $D,[4] while the Year 2 through Year 4 returns would together reflect overpayments of approximately $B, resulting from the Year 5 NOL carryback.

According to the Associate Area Counsel attorney, approximately $C in prepayments are being held for the group by the Service for Year 4. The receiver's attorneys' statements indicate that these payments were made with funds provided by Sub 1.

Because the receiver was fearful that the refunds might be sent to Parent, the receiver sought advice from the Service before filing any of the returns or amended returns to confirm that the returns had to be consolidated returns and to determine how to insure that the refunds would be sent to the receiver.

---

[3]Each subsidiary is severally liable for the entire consolidated return tax. See Treas. Reg. § 1.1502-6.

[4]Resulting from an AMT adjustment.

The “Prior FSA”

In the Prior FSA, we instructed the Director to break agency between Parent and Sub 1 with respect to the consolidated tax liability for Year 1, Year 2 and Year 3 in order to deal directly with Sub 1 instead of Parent as agent.

We noted that not to break agency for the prior Year 1, Year 2 and Year 3 years would be inequitable given that for Year 4 and Year 5 (the loss year), the Service would be dealing directly with Sub 1 with regard to Sub 1’s liability for the entire consolidated tax, while the Service would be dealing with Parent for the earlier Year 1, Year 2 and Year 3 tax years. We also noted that additional issues might be raised if the Service does not break agency for Year 1, Year 2 and Year 3 as to which member the Service should deal with under Treas. Reg. § 1.1502-77 for determining the amount of the net operating loss for Year 5 in light of the fact that taxpayer will be carrying back the Year 5 net operating loss to Year 2 and Year 3.

Furthermore, since Parent continues to be a disinterested party with respect to matters involving the tax liability of the consolidated group, we believe that it is unlikely that it will file a claim for a refund. We noted that Sub 1 is the only member attempting to comply with its obligations with respect to the tax liability of the consolidated group. If Parent fails to file the refund claim and if the Service did not break agency, we noted that Sub 1 would be unable to seek a refund for those earlier years.

The Prior FSA recommended that, in order to protect the Service from any risk of having to pay multiple refunds, the Service should not issue a refund to any member of the group without having first interplead the other members of the group in a refund action filed by the member seeking the refund.

It is our understanding that after the Prior FSA was issued, Sub 1 filed a Year 4 and Year 5 consolidated return.

LAW AND ANALYSIS

IRC § 6402(a) requires the Service to make a refund to the "person who made the overpayment." An "overpayment" of tax is defined as a payment of tax that exceeds the correct tax liability for the period in question. The Supreme Court has defined an "overpayment" as a payment of "more than is rightfully due" See Jones v. Liberty Glass Co., 332 U.S. 524, 531 (1947), reh’g denied, 333 U.S. 850 (1948). Assuming that an examination of the members of the consolidated group is performed and the examination reflects that a refund is due, this FSA must address who is the correct party to pay the refund, i.e., which party made the overpayment at issue.

Consolidated Groups- In General

Typically, the Service pays the refund to the common parent and such payment discharges any liability the Government has to each and every subsidiary. Treas. Reg. § 1.1502-77(a) expressly provides that "The common parent will file claims for refund or credit, and any refund will be made directly to and in the name of the common parent and will discharge any liability of the Government in respect thereof to any such subsidiary;.." See also Swift & Co. v. U.S., 67 Ct. Cl. 322, 331 (1929) (A claim for a refund by the common parent of a consolidated group on behalf of a subsidiary will be treated as a claim by the subsidiary. Therefore, any refund would normally be made to the common parent as agent for the group). Where the Service pays the refund to a common parent as agent for the members of the group, it is not necessary for the Service to determine, for purposes of making a refund, which member or members of the group made the overpayment.

Where Agency is Broken

After the Service has broken the common parent's agency authority with regard to any member of the consolidated group, pursuant to the last sentence of Treas. Reg. § 1.1502-77(a), a subsidiary's filing of a consolidated return does not constitute the filing of a consolidated return by or on behalf of the common parent or the other subsidiary members of the group, even though such return should contain all the income and expenses of all members of the group. Therefore, the consolidated return filed by Sub 1 doesn't serve as the filing of a consolidated return by the Parent or by the other subsidiaries of the group.

Under the facts of this case, if we did not break Parent's agency with Sub 1, we could have sent the refund to Parent and this would have satisfied the Service's obligation to each and every member of the group (regardless of which member or members made the overpayment). One of the reasons we directed that agency be broken between Sub 1 and Parent was to make it possible for Sub 1 to satisfy its obligation to file a consolidated return. This was done in light of the fact that Parent was unwilling to file the consolidated return on behalf of the members of the group. Furthermore, as previously mentioned, Sub 1 would not have been able to file a claim for a refund in the absence of the Director breaking the agency of the common parent. The suggestion by the Associate Area Counsel that we should pay the common parent implies that we should not have broken the common parent's agency authority.

Several Liability

As previously mentioned, IRC § 6402(a) requires the Service to make a refund to the "person who made the overpayment." In the context of a consolidated group, each member is severally liable for the entire consolidated tax of the group. See

Treas. Reg. § 1.1502-6. If Parent paid the tax as agent for the group, the consolidated return regulations are not clear as to whether Parent is paying the tax solely in satisfaction of its own several tax liability or is paying this consolidated tax as agent on behalf of one or more subsidiary members of the consolidated group. Notwithstanding that a subsidiary member might have generated the income, expenses and tax liability, it is the common parent to whom the Service must ordinarily pay the refund where the common parent is the agent for that member as well as the other members of the group. Thus, where the common parent remains the agent for the group, the question underlying your request for field service advice is moot.

In the instant case, the agency between Sub 1 and the common parent is broken and there is no agent to act for the group (which would include Sub 1). The Service is faced with the problem of determining which member or members of the group made the overpayment. Even assuming a refund is due, there is no guidance in the Internal Revenue Code nor the consolidated return rules which definitively determines whether Sub 1 or Parent is entitled to the refund. The danger is that Parent may also attempt to obtain a refund in the event the Service pays the refund to Sub1.

If Sub 1 paid the withholding tax for Year 4 and Year 5, it could be argued that such payment was paid only with regard to its own tax liability and therefore for those years Sub 1 could be identified to be the taxpayer who made the overpayment. However, since these payments by Sub 1 were presumably made before the common parent's agency was broken, such payment could be construed as payments of Parent (i.e., that Sub 1 made such payments on behalf of Parent, because Parent is normally the party that pays the consolidated tax for the members of the group.) If that is the case, then this puts us back to the question of how do we ascertain who were the party or parties (the member or members of the group) that the common parent was making this tax payment on behalf of.

Therefore, as previously mentioned in our Prior FSA, the Service should protect itself by interpleading all members of the group (and successors of members) after a refund action is brought by one or more members of the group.

Assumptions with Respect to This FSA

For the purposes of this FSA, we have made the assumption that an examination of the returns would be completed which would reflect that a refund is due. It is our understanding that: the Service has not yet examined the claims, Parent has never filed a return for Year 4 or Year 5, and the Service does not have the cooperation of (nor the records of) various members of the Parent group.

The Service examines a claim before paying the requested refund. An examination in this case would likely resolve the question of whether Parent or Sub 1 is the person who in fact made any actual estimated tax payments with regard to the tax year for which a refund is sought (notwithstanding, as mentioned above, that ascertaining this fact may not be dispositive as to which member or members would be determined to have made the overpayment for purposes of IRC § 6402).

Other Considerations

Furthermore, the Service may not discharge its duty to make a refund to the proper party by disbursing funds to one claimant and allowing the claimants to battle it out among themselves. If the Service refunds monies to the wrong party, a valid claim by the proper party to the refund may remain. Thus, to protect the Service from any possibility of having to pay the refund twice, the Service should be certain that the party to whom it pays the refund is, in fact, the person who made the overpayment. Where, as here, the identity of that person is unclear, the Service should deny the claim.

Interpleader

As recommended in our prior advice, the Service should not issue a refund to any member of the group without having first interplead the other members of the group in a refund action.

Please call if you have any further questions.

Jasper L. Cummings, Jr.
Associate Chief Counsel
By: STEVEN J. HANKIN
Senior Technician Reviewer
CC:CORP:Br.6