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subject: Timeliness of a Claim for Refund under Sections 6511(d)(2) and 6511(d)(3)

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ISSUE

Whether a refund claim filed in year 13 is timely for taxes paid for year 2 if the claim for refund results from a Net Operating Loss (NOL) in year 4 that was generated when the taxpayer made a timely election to deduct foreign taxes paid in lieu of the previously claimed foreign tax credit?

CONCLUSIONS

No. The claim for refund of tax paid with respect to year 2 is the result of an NOL in year 4. The timeliness of the claim for refund is governed by section 6511(d)(2) because it is attributable to an NOL carryback from year 4. The applicable period therefore expired three years after the due date of the return for year 4. Even if the claim for refund were viewed as attributable to foreign taxes paid, the ten-year period under section 6511(d)(3) is only available for refunds attributable to foreign tax credits; it does not apply to refunds attributable to deductions for creditable foreign taxes. The extended periods under subsections (d)(2) and (d)(3) are mutually exclusive with respect to a given overpayment.

FACTS

In year 13 a taxpayer filed an amended return for year 4. On the amended return, the taxpayer changed its election in order to deduct creditable foreign taxes under section 164, in lieu of taking the credit under section 901. This new deduction, for foreign taxes paid or accrued, significantly reduced the taxpayer's income. The reduction in income caused by the deduction for foreign taxes resulted in a Net Operating Loss (NOL) for year 4. On the same day that the taxpayer filed an amended return for year 4, the taxpayer also filed an amended return for year 2, carrying back the NOL from year 4 to year 2. The taxpayer's original returns for fiscal years 2 and 4 were timely filed in calendar years 2 and 4, respectively. Neither year was the subject of an extension within the meaning of sections 6501(c)(4) and 6511(c).

LAW AND ANALYSIS

Law

Section 901 (a) provides that if a taxpayer chooses the benefit of the foreign tax credit, subject to the limitations in section 904, the taxpayer's income tax will be credited with the amounts allowed under section 901(b) plus, in the case of a corporation, the taxes deemed paid under sections 902 and 960. Such choice may be made or changed at any time prior to the expiration of the period prescribed for making a claim for credit or refund for the taxable year.

Treasury Regulations section 1.901-1(d) clarifies that the relevant period for a taxpayer to claim the benefits of section 901 (or claim a deduction in lieu of a foreign tax credit) is the period prescribed by section 6511(d)(3)(A) (or section 6511(c) if the period is extended by agreement).

Section 6511(d)(2)(A) provides that when a claim for refund relates to an overpayment attributable to an NOL carryback, in lieu of the three-year period prescribed in section 6511(a), the period ends three years after the time prescribed by law for the filing of the return (including extensions) for the taxable year of the NOL which results in the carryback, or the period prescribed in section 6511(c) in respect of such year, if later.

Section 6511(d)(3)(A) provides that if a claim for credit or refund relates to an overpayment attributable to a tax paid or accrued to a foreign country for which credit is allowed under section 901, in lieu of the three-year period prescribed in section 6511(a), the period is ten years from the date prescribed for the filing of the return for the taxable year in which the foreign tax was actually paid or accrued.

Treasury Regulation section 301.6511(d)-3(a) provides that in the case of an overpayment resulting from a credit allowed under section 901 for taxes paid or accrued to a foreign country, a claim for credit or refund must be filed within ten years from the due date, without regard to extensions, of the return for the taxable year with respect to

which the claim is made (the regulation has not been updated to reflect a change in the statutory language to clarify that the period runs from the due date of the return for the year in which the foreign tax is actually paid or accrued).

Analysis

You asked whether a claim for refund of tax paid for year 2 is timely filed under section 6511(d)(2) or (d)(3), where an amended return is filed in year 13 claiming a deduction, in lieu of a credit, for foreign taxes paid in year 4, the timely election to deduct foreign taxes in year 4 results in an NOL for year 4, and the claim for refund for year 2 is also filed in year 13 based on an NOL carryback from year 4 to year 2. The claim for refund filed by the taxpayer for year 2 is not timely under either section 6511(d)(2) or section 6511(d)(3).

1. Timeliness under section 6511(d)(2)

First, refunds attributable to an NOL are generally governed by the special limitation period set out in section 6511(d)(2). A claim for refund based on an overpayment of tax attributable to an NOL carryback is timely if filed within three years of the due date (including extensions) of the return for the loss year. In this case, the loss year is year 4 and the due date of the year 4 return was also in year 4. Therefore, the three-year period, following the due date of the NOL source year return for year 4, expired in year 7. The taxpayer's claim for refund made in year 13 is therefore untimely under section 6511(d)(2).[1]

2. Timeliness under section 6511(d)(3)

The taxpayer may argue that an overpayment in year 2 is "attributable to" a foreign tax paid or accrued and therefore falls within the purview of section 6511(d)(3). However, this reading is incorrect for several reasons.

First, the taxpayer in this case has elected to take a deduction for foreign taxes paid or accrued under section 164, not a credit under section 901. The ten-year period of limitations under section 6511(d)(3) applies only to claims based on foreign tax credits allowed under section 901, not deductions of foreign tax for which a credit is allowable. The distinction between allowed and allowable is an important one. A foreign tax credit or a deduction for foreign taxes paid or accrued may each be allowable, but they are also mutually exclusive; the taxpayer is required to choose only one option for a given tax year. This is explicitly outlined in section 275(a)(4) and the regulations under

[1] Section 6511(d)(2) is not an exclusive period of limitations. A claim for credit or refund made outside of the three-year period prescribed in section 6511(d)(2) will still be considered timely, if the claim falls within the periods prescribed in section 6511(a), (b), or (c), as applicable. Treas. Reg. § 301.6511(d)-2(a)(3). However, the taxpayer's claim for refund of taxes paid in year 2 is also untimely under sections 6511(a) and (b), and on the facts provided, section 6511(c) is inapplicable, since no extension of time for assessment was granted with respect to year 2.

sections 164 and 901. A credit is allowable unless a deduction is taken, and a deduction is allowable unless a credit is taken. However, only one or the other can be allowed in a given year. A credit is only allowed when chosen; conversely, it is not allowed when a deduction is taken in lieu of that credit. *See* Treas. Reg. § 1.901-1(h).

Consequently, since section 6511(d)(3) is only applicable to overpayments attributable to foreign taxes for which credit is allowed, it is inapplicable to overpayments attributable to foreign taxes claimed as a deduction. In short, deducted foreign taxes are not "taxes paid or accrued to any foreign government… for which credit is allowed against the tax imposed by subtitle A in accordance with section 901," for purposes of section 6511(d)(3). This is clarified in Treasury Regulation § 301.6511(d)-3, which only provides for a ten-year period with respect to claims based on foreign tax credits under section 901.

Second, even if section 6511(d)(3)(A) could be construed to apply to overpayments attributable to foreign tax deductions, the overpayment claimed in year 2 is not attributable to a deduction for foreign tax paid or accrued; rather, it is attributable to an NOL deduction carried back from year 4. The phrase "attributable to" was defined by the Federal Circuit as "due to, caused by, or generated by." *Electrolux Holdings, Inc. v. United States*, 491 F.3d 1327, 1331-33 (Fed. Cir. 2007). In *Electrolux* the court found that the taxpayer's claim was "attributable to" the capital loss carryforward that generated the overpayment, not the original capital loss carryback that was carried back and then carried forward to generate the overpayment. *Id.* The court rejected the taxpayer's argument that a carryover was "attributable to" a carryback simply because it could be "traced to" the carryback. *Id.* This indicates that in a cascading sequence, such as the one presented here, the most immediate cause of the overpayment should be considered for purposes of determining what the overpayment is "attributable to." *But see*, *First Chicago Corp. v. Commissioner*, 742 F.2d 1102 (7th Cir. 1984) (using tracing in the context of section 6501 period of limitations on assessment, to attribute the last step in a cascade to the initiating event which is removed by several steps).[2]

The narrower reading of "attributable" found in *Elextrolux*, in contrast to the tracing method used in *First Chicago*, is consistent with the fact that waivers of sovereign

[2] *Marshalltown* is sometimes referenced with respect to this issue. The court in *Marshalltown*, on a motion to dismiss, found that section 6511(d)(2) would allow the case to go forward, where a carryback from 1985 to 1979 freed credits which could be carried to 1980. *Marshalltown Savings & Loan Ass'n v. United States*, No. 4–91–CV–10003, 1991 WL 331376 (S.D.Iowa Dec. 31, 1991). In *Marshalltown*, the court finds without citation or analysis that the carryforward of credits from 1979 to 1980 is attributable to the net operating loss which freed those credits. This is an unreported order without significant analysis on point which creates more questions than answers. For example, the order fails to explain why this scenario is distinguishable from the scenario in Rev. Rul. 71-533, 1971-2 C.B. 413, which holds that when a foreign tax credit is freed up as the result of an NOL carryback, those credits are subject to the period of limitations applicable to the foreign tax credit at issue, not the NOL which freed those credits. There is no justification provided to treat the business credit freed in *Marshalltown* different than the foreign tax credits freed in Rev. Rul. 71-533.

immunity and the associated periods of limitations must be construed strictly in favor of the Government. *See e.g.*, *United States v. Brockamp*, 519 U.S. 347 (1997); *United States v. Dalm*, 494 U.S. 596 (1990). In *First Chicago*, the Court was required to construe a limitation on assessment in favor of the Government and thereby took a broad interpretation of "attributable to" while in *Electrolux*, the Federal Circuit was required to strictly construe the waiver of sovereign immunity for suits against the Government and thus construed "attributable to" narrowly. Therefore, we do not view *Electrolux* and *First Chicago* as inconsistent. On the contrary, the two cases together provide the book ends of "attributable to" defining the term when it must be read narrowly, and when it must be read broadly. In the context of a waiver of sovereign immunity, the phrase must be construed narrowly and therefore applies only to the immediate cause, while in the context of a statute of limitations on the collection of taxes, the phrase must be construed broadly in favor of the government and therefore includes all items within the chain of causation including the initial event which caused the cascade effect. Since the claim in this case relates to a refund claim, and therefore a waiver of sovereign immunity, the phrase must be construed narrowly to incorporate only the immediate cause of the claim.

This result can also be reached by careful statutory construction. Sections 6511(d)(2) and 6511(d)(3) each provide a period, "in lieu of the 3-year period of limitations prescribed in subsection (a)." Section 6511(d)(3) states that the period used in lieu of the three-year period "shall be 10 years from the date prescribed by law for filing the return for the year in which such taxes were actually paid or accrued," while section 6511(d)(2) states the period used in lieu of the three-year period "shall be that period which ends 3 years after the time prescribed by law for filing the return (including extensions thereof) for the taxable year of the net operating loss or net capital loss which results in such carryback, or the period prescribed in section (c) in respect of such taxable year, whichever expires later." Therefore, a given overpayment cannot be treated as attributable to both a net operating loss and a foreign tax for purposes of determining the statute of limitations, without causing a conflict between these two provisions.

Where statutes seem to conflict, the preferred reading for purposes of statutory construction is one which allows for the provisions to operate harmoniously with the most specific provision applying when possible. Therefore, the best reading of section 6511(d) is that the most immediate cause of the overpayment must be the cause to which the overpayment is "attributable." In this case, the most immediate cause of the claimed overpayment is the NOL. It is the NOL deduction which creates the overpayment in year 2. The foreign tax is only one item which may contribute to an NOL in year 4, but without the existence of an NOL in year 4, the year 2 tax could not be an overpayment of tax. Therefore, the NOL is the direct cause and the foreign tax is, at best, one of multiple indirect causes. Therefore, the period used in lieu of the three-year period in subsection (a) as determined by the most narrowly tailored statutory provision would be the period prescribed in 6511(d)(2). In this sense, the stricter reading of "attributable to" in the context of section 6511(d), but not in the context of

other provisions, could be justified by the specific context which requires a stricter construction so as to avoid unnecessary conflicts within the statutory framework.

Furthermore, in a similar context Congress has expressly articulated its intent that more than one limitations period can apply to a given overpayment based on the cascading effect of a specific deduction on a carryover or carryback. For example, in section 6511(d)(1) Congress explicitly provided for an extended period of limitations running from the claim year, when an overpayment results from either a bad debt or worthless security deduction *or* from the effect such a deduction has on the application to the taxpayer of a carryover. Section 6511(d)(1) also provides for an alternative period of limitations running from the NOL year, and the use of the longer of the period in subsection (d)(1) and (d)(2), where a bad debt or worthless security deduction affects the application to the taxpayer of a carryback. By failing to explicitly provide a similar rule extending the NOL limitations period in section 6511(d)(2) where a foreign tax deduction, rather than a bad debt deduction, affects the application of the NOL carryback, Congress has implicitly rejected any attempt to infer such an extension through a strained reading of section 6511(d)(3). If Congress intended to permit a taxpayer to use a longer period than that allowed by section 6511(d)(2) where foreign tax deductions affected the operation of an NOL carryback, then Congress would have enumerated that intention as it did in subsection (d)(1).

This conclusion is further supported by the holding in Rev. Rul. 71-533, 1971-2 CB 413. In the revenue ruling, a taxpayer used an NOL to free FTCs which the taxpayer then carried back to offset its tax in the carryback year. The ruling held that the statute of limitations applicable to the FTCs was applicable, not the statute of limitations applicable to an NOL. Consequently, the most immediate cause of the claim controls, as opposed to items further removed in a sequence of related adjustments.

While it is not a firmly settled principle of law, we believe that the best and most consistent reading of “attributable to” in the context of sections 6511(d)(2) and (3) is the most immediate or direct cause of the overpayment. Therefore, even if section 6511(d)(3)(A) were construed to apply to claims based on foreign tax deductions, the taxpayer is not entitled to the ten year period of limitations because the year 2 claim for refund is not related to an overpayment of tax “attributable to” a section 164 deduction for foreign tax paid or accrued in year 4. It is attributable to a section 172 deduction for an NOL carried from year 4.

Third, even if “attributable to” was interpreted in its broadest sense and the deduction was traced through the NOL deduction to its component parts, the NOL is unlikely to comprise deductions for creditable foreign taxes. While an NOL is properly treated as a separate deduction under section 172, if we were to look through the section 172 deduction, then we must determine which deductions from year 4 make up the NOL. We do not have sufficient facts to properly allocate the deduction to determine what portion, if any, of the NOL carryback under section 172 would be attributable to the deductions taken under section 164 for creditable foreign taxes. However, given the nature of foreign tax deductions, and the likelihood of them being absorbed by the

related foreign source income, we find it unlikely that a significant portion of the NOL would be derived from the section 164 deduction after all deductions are properly allocated.[3]

The process of allocating all deductions in the loss year and stacking them in order to determine which deductions comprise the NOL carryback deduction can be quite complicated. We do not feel that it is necessary to fully develop this argument here because the question should be resolved without reaching this difficult factual analysis. However, we believe that it is an important alternative argument that we can develop in supplemental advice if it becomes necessary. In fact, the difficulty of the process of attempting to look through an NOL deduction in order to determine whether the period of limitations is open provides further support to the notion that Congress could not have intended for taxpayers and the Service to look through an NOL in order to determine if another period of limitations could apply based on its component parts. Rather, if Congress had intended special rules for foreign tax deductions that affect the application of an NOL carryback, it would likely have provided a different statutory mechanism (e.g., a mechanism comparable to the one provided in section 6511(d)(1)), rather than leaving taxpayers and the Service to devise a tracing rule.

3. Stacking of Section 6511(d)(2) and (d)(3)

There is no stacking of benefits under sections 6511(d)(2) and (d)(3) to provide a longer period. Sections 6511(d)(2) and (d)(3) operate as a set period of three years or ten years. These periods key-off of specific dates, the due date of the return for the year of the NOL or FTC, or in some cases the period prescribed under subsection (c). The plain language of the statutes indicates that the periods are mutually exclusive with respect to any given overpayment. The overpayment must either be subject to the period in section 6511(d)(2) or section 6511(d)(3). *Compare* I.R.C. § 6511(d)(1) (where Congress explicitly provides for the use of the period in either section 6511(d)(1) or section 6511(d)(2), whichever is longer, if a bad debt or worthless security deduction increases an NOL that affects the application of a carryback) *with* the absence of any comparable provision in I.R.C. §§ 6511(d)(2) or (d)(3) *and* Rev. Rul. 71-533, 1971-2

[3] According to Treasury Regulation section 1.861-8(e)(8), an NOL deduction allowed under section 172 shall be allocated and apportioned in the same manner as the deductions giving rise to the net operating loss deduction. Therefore, the deductions for the year of the loss must be allocated under ordinary rules before determining which deductions make up the deduction carried back under section 172. The NOL itself should not be viewed as attributable to whatever deduction the taxpayer finds most advantageous, or the deduction claimed most recently in time. Instead, all deductions for the year should be properly allocated and then, the deductions that are not absorbed in the year incurred are converted into the NOL deduction. Foreign tax deductions under section 164 are generally allocated to the class of gross income to which the taxes factually relate. Treas. Reg. § 1.861-8(e)(6)(i) ("The deduction for state, local, and foreign income, war profits and excess profits taxes ('state income taxes') allowed by section 164 shall be considered definitely related and allocable to the gross income with respect to which such state income taxes are imposed."). Therefore, the foreign tax deductions under section 164 will generally be allocated to offset the foreign source gross income in the year paid or accrued, before any portion of the deductions could become part of an NOL.

C.B. 413, (holding that in the reverse fact pattern, where a foreign tax credit is freed up and carried back as the result of an NOL carryback, the resulting overpayment is subject to the period of limitations applicable to the foreign tax credit at issue, not the NOL that freed up those credits).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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