IRS Hot Topics

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IRS Chief Counsel releases legal advice determining that ten-year period of limitations under section 6511(d)(3)(A) does not apply to refund claims based on foreign tax deductions

In a Chief Counsel Advice (CCA) memorandum, dated October 21, 2011 and released January 27, 2012, Chief Counsel of the Internal Revenue Service (IRS) rejected as untimely the claim of a US consolidated return group parent corporation for a refund based on an election to deduct, rather than credit, foreign taxes paid by a subsidiary in a past tax year. The CCA concluded that the refund claim was untimely because the special ten-year period of limitations provided by section 6511(d)(3)(A) only applied if the refund claim related to an overpayment attributable to any taxes paid or accrued for which credit, and only a credit, is claimed against US income tax under section 901. The ten-year period was not applicable to the taxpayer's refund claim based on a deduction of foreign income taxes paid.

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Under the facts considered in the CCA, the taxpayer filed Forms 1120X, *Amended US Corporation Income Tax Return*, for several tax years for which the original returns were filed more than three years, but less than ten years before the amended returns. Pursuant to Treas. Reg. section 1.901-1(d), all the amended returns elected to

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change previously claimed foreign tax credits to deductions for foreign taxes accrued in each tax period. The elections caused the aggregate net operating losses (NOL) for such years to be increased. For one particular year (Year 1), an NOL was generated. Subsequently, the taxpayer filed a Form 1120X for Year 2 to reflect the carryback of an increased Year 1 loss. The increased NOL carryback resulted in an overpayment for Year 2, which led the taxpayer to file a claim for refund. The claim for refund was made within a ten-year period following the original due date (without extensions) for the Year 1 tax return.

Under section 6511(a), a claim for refund must be filed within three years of the time a tax return was filed or two years from the time the tax was paid, whichever period expires later. However, section 6511(d) provides a special limitation period for claims attributable to foreign taxes paid or accrued. Under section 6511(d)(3)(A) if a refund claim "relates to an overpayment attributable to tax paid or accrued to any foreign country or to any possession of the United States for which credit is allowed" under section 901(a) or by a treaty, the taxpayer has ten years from the date provided for filing the return to make the election and to file a timely claim for such overpayment.

Section 901(a) provides rules that permit a taxpayer to take a tax credit or a deduction (but not both) for foreign taxes paid or accrued by the taxpayer. Section 901 permits the election between credit or deduction to be made so long as the refund period for such year is open. Treas. Reg. section 1.901-1(d) then defines the refund period by referencing the ten-year period of section 6511(d)(3)(A) and stating that the taxpayer may, for a particular taxable year, claim a credit or claim a deduction in lieu of a foreign tax credit at any time before expiration of the period prescribed by section 6511(d)(3)(A) (or section 6511(c) if the period is extended by agreement). Therefore, a straight-forward reading of the section 901 provisions would permit the foreign tax election to be made, and a refund claim made, within the ten-year period.

Nevertheless, the CCA determined that the ten-year period of section 6511(d)(3)(A) did not apply to the Year 1 amended return. The CCA stated that pursuant to the plain language of section 6511(d)(3)(A), the ten-year period of limitations only applies if the claim for refund or credit related to an overpayment attributable to any taxes paid or accrued for which credit is allowed against US income tax under section 901 [emphasis in CCA]. The CCA emphasized the "allowed" credit in the section, instead of the usage of "allowable" credit; the distinction between these two words is an "important one" according to the CCA. Citing the Random House Dictionary, the CCA stated that "allowable" is defined as "that which may be allowed, legitimate, permissible." In seeming contrast, according to the CCA, "allowed" is defined as that which is permitted.

The CCA attempted to apply its distinction of these words to the application of section 6511(d)(3)(A). The CCA stated:

Under section 275(a)(4) and the regulations under IRC sections 164 and 901, a deduction for foreign taxes paid or accrued is *allowable* unless and until the foreign tax credit has been claimed with respect to the such taxes [emphasis added]. Once a credit is taken, such deduction is not allowed; similarly a foreign tax credit is allowable for such taxes unless and until a deduction has been claimed…at which point the credit is not allowed.

The CCA paired the term "allowed" with a requirement that the foreign tax credit actually and finally be claimed and produce a tax benefit for the taxpayer in order to be "allowed." Therefore, the CCA determined that in reading section 6511(d)(3)(A), an "allowed" credit, to which the special ten-year period of limitations applies, can only refer to the foreign tax credit, and not the foreign tax deduction for which a credit would have been allowable.

Observations

The CCA's determination that the ten-year special period of limitations under section 6511(d)(3)(A) does not apply to a taxpayer's foreign tax deduction is tenuous and open to challenges given the CCA's rationale for the determination and also given that Chief Counsel of the IRS has previously determined that the ten-year period of section 6511(d)(3)(A) applied to elections for foreign tax deductions. First, the CCA takes the position that there is a distinction between "allowed" and "allowable" in the context of section 6511(d)(3)(A). The CCA attempts to give these two terms static definitions by relying on definitions of the words provided by a single English dictionary. Arguably, the definitions of "allowed" and "allowable" are more appropriately determined based on the Congressional purpose and intent of the particular section where the terms are found. The regulations, and related legislative history of section 6511(d)(3)(A) provides no indication that Congress intended to distinguish the terms "allowed" and "allowable;" therefore, "allowed" should be read as "allowable" in the context of section 6511(d)(3)(A).

Second, the CCA's interpretation seems to put section 6511(d)(3)(A) into conflict with section 901 and its regulations. While the CCA recognizes the election to deduct under section 901, the CCA does not seem to recognize that its interpretation of section 6511 may conflict with the provisions of section 901 in that Treas. Reg. section 1.901-1(d) provides the times prescribed for making the credit/deduction choice, and hence the period of limitations for claims resulting from that choice.

This 901 regulation clearly states that the period of limitations for refunds attribution to foreign tax deductions is the ten-year period provided by section 6511(d)(3)(A) (the only period prescribed by section 6511(d)(3)(A)). The CCA does not seem to recognize that this regulation, in the context of the statute it interprets, specifies that a taxpayer may claim a foreign tax credit under section 901 or claim a deduction in lieu of a foreign tax credit, and obtain a refund at any point during the ten-year period of limitations. The CCA does not reconcile these provisions. Further, the CCA does not

reflect on possible Congressional intent or policy for a limitations rule that would allow the ten-year period when a taxpayer changes from a deduction to a credit but not when the taxpayer changes from a credit to a deduction.

Finally, the CCA's position is further perplexing in that previous Chief Counsel advice (although non-precedential) has stated that section 6511(d)(3)(A) provides that a taxpayer may elect to take a foreign tax credit or a deduction for foreign taxes paid or accrued, or change from a credit to a deduction or from a deduction to a credit within the ten-year period and obtain a refund. The CCA changes this interpretation without discussing or distinguishing the prior positions of the Office of Chief Counsel.

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