

Filing of Tax Court petition precludes later challenge to interest and penalties, says Claims Court

November 25, 2013

In brief

The US Court of Federal Claims on July 13 dismissed for lack of jurisdiction a suit brought by The Cheesecake Factory, Inc. (the taxpayer) for a refund of interest and penalties. The court agreed with the government that the suit was barred by Section 6512(a), which severely restricts the allowance of refunds or credits, and the bringing of refund suits, for any tax years for which the taxpayer has received a statutory notice of deficiency (90-day letter) and filed a petition with the US Tax Court.

This decision should be of interest to companies that recently have litigated (or may litigate) issues in the Tax Court.

In detail

Background

On June 26, 2006, the taxpayer filed an amended return to carry back a 2004 net operating loss to 2003. The amended return reported an overpayment of \$3.3 million for 2003 that the taxpayer requested be applied to its 2005 Form 1120 (i.e., corporate income tax return) account. In August 2006, the taxpayer filed its 2005 tax return on which it reported a tax liability of \$21.1 million. When the 2005 return was processed, the IRS's records reflected payments and credits for 2005 of only \$18.2 million, which amount did not include the above-described \$3.3 million overpayment claimed for 2003. As a result, the IRS assessed a Section 6651(a)(2) late-payment

penalty of \$132,771 and underpayment interest of \$157,041 (and also, presumably, issued notice and demand for the unpaid tax of \$2.9 million). The 2003 overpayment, including about \$1,000 of overpayment interest, ultimately was credited to the taxpayer's 2005 Form 1120 account on March 15, 2007.

In June 2007, the taxpayer filed a second amended return for 2003, along with amended returns for 2004 and 2005. The second amended 2003 return decreased the taxpayer's overpayment for that year by approximately \$395,000, while the 2004 amended return resulted in an overpayment of \$5.1 million that at the taxpayer's request was applied

to its 2005 Form 1120 account as of April 15, 2005. The amended return for 2005 requested, among other things, a refund of the late-payment penalties and interest. On October 1, 2007, the IRS assessed a second late-payment penalty of \$44,257 and additional underpayment interest of \$98,211 for the 2005 tax year. In February 2009, the IRS notified the taxpayer that it had partially disallowed the refund claims.

On July 2, 2009, the IRS issued a statutory notice of deficiency (90-day letter) to the taxpayer for tax year 2005, asserting a deficiency of \$698,705 and an accuracy-related penalty in the amount of \$138,741. The taxpayer filed a petition with the

US Tax Court and the case was resolved in August 2010 when the court entered a decision stipulated by the parties that reduced the tax deficiency for 2005 to \$383,743 and eliminated the accuracy-related penalty. The late-filing penalties and interest were not addressed in the notice of deficiency, the taxpayer's Tax Court petition, or the stipulated decision.

On July 2, 2012, the taxpayer filed a refund suit in the Claims Court for the late-payment penalties and interest (together totaling \$432,280) it paid for 2005. The government moved to have the refund suit dismissed for lack of jurisdiction on the basis that it was prohibited by Section 6512(a).

Applicable law

Pursuant to Section 6512(a), if a taxpayer who receives a statutory notice of deficiency files a petition with the Tax Court, the court acquires exclusive jurisdiction to determine the existence of a deficiency or an overpayment in tax for the tax years covered by the statutory notice. Accordingly, no credit or refund of tax (income, gift, estate, and certain excise taxes) for the same tax year shall be allowed or made, and no refund suit in any other court may be brought, except with respect to:

- Overpayments determined by a decision of the Tax Court that has become final;
- Any amount the IRS collects that is in excess of the tax computed in accordance with the final decision of the Tax Court;
- Any amount collected after the period of limitations for collection has expired;

- Overpayments attributable to partnership items that are determined at the partnership level in a separate proceeding, according to the TEFRA partnership rules of Sections 6221 to 6233;
- Any amount that was collected within the period during which the IRS is prohibited from collecting by levy or through a court proceeding under Section 6213(a); or
- Any claim for credit or refund of an overpayment, not contested on appeal, that the IRS is authorized to refund under Section 6512(b)(1).

Claims Court ruling

The Claims Court granted the government's motion to dismiss the refund suit, concluding that it lacked jurisdiction over the case because the taxpayer was seeking a refund for the same year covered in a deficiency notice and in the taxpayer's petition to the Tax Court.

The court disagreed with the taxpayer's contention that the interest and penalty issues could not have been raised in the Tax Court case, because while those items were not included in the notice of deficiency the Tax Court's jurisdiction extends to "the entire subject of the correct tax for the particular year." Moreover, the court stated that the bar against refund suits under Section 6512(a) would apply even if those issues could not have been raised before the Tax Court.

The takeaway

Accordingly, when a refund opportunity based on overpaid deficiency interest is identified while a

Tax Court case is pending, the taxpayer should discuss with counsel whether the Tax Court petition can or should be amended to raise the interest issues. In light of the decision in *The Cheesecake Factory*, simply deferring the interest issues until after the Tax Court decision has become final is not an option. Section 6512 should not, however, preclude a claim or suit for additional overpayment interest, because such a claim or suit would not involve a refund or credit of money previously paid to the IRS by the taxpayer.

If a dispute arises over the IRS's computation of interest due on a tax deficiency determined by the Tax Court, pursuant to Section 7481(c) the taxpayer may, within one year from the date the Tax Court decision becomes final, move to reopen the case for the sole purpose of having the court determine whether (1) the taxpayer has made an overpayment of interest (i.e., paid the IRS too much deficiency interest) or (2) the IRS has made an underpayment of interest (i.e., failed to pay the taxpayer enough overpayment interest).

Because Section 7481(c)(1) speaks in terms of "a redetermination (by the Tax Court) of the amount of interest *involved*" (emphasis added), a motion filed under that section might be limited to interest directly related to the deficiency or overpayment determined by the court, thereby precluding a motion involving previous instances in the same tax years in which the taxpayer may have paid too much underpayment interest or received too little overpayment interest.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

Managing Accounts

Mike Urban
(202) 414-1716
michael.urban@us.pwc.com