Federal Claims Appeals: redetermined foreign taxes relate back to the year incurred, not the year when finalized

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In brief

On August 13, 2015, the US Court of Appeals for the Federal Circuit (Federal Circuit) held that that the 10-year statute of limitations that Section 6511(d)(3)(A) prescribes for filing a foreign tax credit (FTC) refund claim begins in the year to which the foreign taxes relate, rather than the year in which the foreign taxes are finally paid. That decision affirmed a US Court of Federal Claims' (Claims Court) opinion in *Albemarle Corp. v. United States* (*Albemarle*) and largely adopted the trial court's reasoning.

Following the three-judge panel's August 13th decision, the taxpayer filed a Petition for Rehearing *en banc,* seeking a reconsideration by the full Federal Circuit bench. On October 22, 2015, the Federal Circuit issued a seven-page document denying the Petition for Rehearing and dismissing the taxpayer's supporting arguments.

The *Albemarle* decision is significant for taxpayers that may have paid (or may be required to pay) additional foreign taxes as a result of a foreign tax audit and would like to claim FTCs for such additional foreign taxes on their US federal income tax return.

In detail

The key issue in the *Albemarle* case has been whether FTCs for redetermined taxes relate back to the year for which they are paid. The Federal Circuit's opinion, like the lower court's, actually addressed a procedural issue: whether the taxpayer filed its US federal income tax refund claim timely under the Section 6511(d)(3) statute of limitations for FTCs. The timeliness of the taxpayer's refund claim turned on whether the 10-year period that Section 6511(d)(3)(A) prescribes for such claims began in the tax year a foreign tax redetermination was finally determined, or in the tax year to which the redetermined taxes related back.

Factual background

Albemarle Corp. was the parent company of a US consolidated group. On December 31, 1996, a Belgian subsidiary of Albemarle issued 20-year securities to members of the US group. Interest was paid on the securities in each year between 1997 and 2001, but the Belgian subsidiary did not pay any Belgian withholding taxes when making the interest payments. Albemarle timely filed its 1997 and 1998 US federal income tax returns on September 15, 1998 and September 15, 1999, respectively.

In 2001, the Belgian tax authorities issued a notice of adjustment, stating that the interest payments were subject to a 25% withholding tax. The Belgian subsidiary formally protested the adjustment but ultimately settled the dispute in 2002. The subsidiary then paid a 15% withholding tax on the interest payments it had made in 1997-2001. The settlement with the Belgian tax authorities specified the withholding tax due for each year, including $412,923.00 for each of 1997 and 1998. Albemarle did not file protective refund claims for the US federal income tax years at issue.

On May 15, 2009, Albemarle filed an amended US federal income tax return for tax year 2002, claiming refunds for the FTCs attributable to the Belgian withholding taxes paid with respect to its 1997-2001 taxable years. The delay in filing a claim for refund was apparently due to substantial changes in company personnel, who were not aware that Albemarle had made no FTC claims for the Belgian withholding taxes. The IRS permitted the refund claims for 1999- 2001 but not the 1997-98 tax refund claims. The IRS position was that the 1997 and 1998 claims should have been made by March 15, 2008, and March 15, 2009, for 1997 and 1998, respectively, to come within the 10-year Section 6511(d)(3)(A) FTC refund claim period.

Albemarle Corp. paid the additional US taxes that the IRS assessed, then sued for refund in the Claims Court. Albemarle argued that its FTC claims were timely for 1997 and 1998 because the 10-year period began in 2002 when its subsidiary settled the Belgian tax dispute and paid the required withholding taxes. In response, the US government filed a motion to dismiss the case for lack of subject matter jurisdiction. The government asserted that the 1997 and 1998 refund claims were filed beyond the 10-year Section 6511(d)(3)(A) window. The government cited Rev. Rul. 84-125, arguing that "a contested foreign tax accrues in the tax year to which the tax relates, not in the year when the contest is resolved and the foreign tax is paid." The Claims Court ruled on the motion, issuing a long opinion that adopted the IRS' reasoning.

The Federal Circuit's analysis

Section 6511(d)(3)(A) was amended in 1997, and effective for taxable years beginning on or after August 5, 1997. The taxpayer claimed FTCs for the Belgian withholding taxes that related to the tax years beginning January 1, 1997 and January 1, 1998, which straddled that effective date. Accordingly, the Federal Circuit addressed both the pre-and post-1997 application of Section 6511(d)(3)(A).

The Federal Circuit began its analysis by considering the post-1997 statutory language that applied to the 1998 withholding taxes. That language provides that an FTC claim is timely only if it is made within "10 years from the date prescribed by law for filing the return for the year in which such taxes were actually paid or accrued." The court considered it undisputed that the year in which the relevant foreign taxes 'accrued' for FTC purposes under Sections 901 and 905 was 1998. The court then focused its analysis on the parties' respective interpretations of the word 'actually.' The court's view was that Albemarle was arguing "the use of the term 'actually' in section 6511(d)(3)(A) requires that the year of accrual for limitations purposes be determined differently from the way it is determined for purposes of sections 901 and 905." That statement echoes the trial court's opinion, which in turn reflected the government's appeal to the need for 'symmetry' between Sections 901 and 6511(d)(3).

The Federal Circuit concludes that Section 6511(d)(3) provides no guidance as to the meaning of the term 'actually.' Further, the court notes that the 'plain meaning' interpretation of the word does not resolve the parties' dispute, because either of two years could be regarded as the year that the tax 'actually accrued'—the year of origin for the tax (1998) or the year in which the contested liability is finalized (2002). The parties' positions on the word 'actually' in the statute did not change materially from the trial court level. Albemarle argued for applying *Dixie Pine Products v. US*, 320 U.S. 516 (1944). In *Dixie Pine*, the Supreme Court held that the taxpayer could not claim a deduction for a contested state tax liability until the tax year in which that adjudication occurred. The government relied on the 'relation-back doctrine,' pointing out that *Cuba Railroad Co. v. US*, 124 F. Supp. 182 (S.D.N.Y. 1954) and Rev. Rul. 58-55 both established that the contested tax doctrine did not apply to FTC issues. The Federal Circuit relies primarily on *US v. Campbell*, 351 F.2d 336, 338 (2d Cir. 1965) for its explication of the relation-back doctrine: "It is well established that a contested foreign tax is counted toward the credit limitation of its year of origin, because that tax is used to offset the U.S. tax liability for the year of origin."

With no clear guidance from the statute, the court considered the circumstances surrounding the 1997 statutory change to Section 6511(d)(3)(A), which changed the language from "the year with respect to which the claim is made" to "the year in which such taxes were actually paid or accrued." The court explains that Congress enacted that language to clarify an ambiguity that led to the result in *Ampex Corp. v. United States*, 620 F.2d 853 (Ct. Cl. 1980). In *Ampex*, the Claims Court determined

that the 10-year period in the pre-1997 version of Section 6511(d)(3) began in the year to which FTCs were carried and claimed against taxes, rather than the year in which the foreign taxes originated. After briefly considering the legislative history relating to the statutory change, the court states "[n]othing in the background of the 1997 amendment suggests that Congress intended for that amendment, which was directed solely at correcting a court decision governing carryover foreign taxes, to change the longstanding rule under which the special limitations period had been calculated for contested taxes."

One telling point that the Federal Circuit makes about legislative intent regards the purpose of a 10-year limitations period. The court cites to two Claims Court cases that noted the 10-year period served to give taxpayers an opportunity to settle foreign tax uncertainties before being subject to IRS requirements. As the Federal Circuit states, "It is highly unlikely that Congress intended to provide the prolonged 10-year limitations period simply to enable a taxpayer to complete the filing process following the resolution of its foreign tax liability."

Interestingly, the court uses the Section 904 regulations, specifically Treas. Reg. sec. 1.904-2(c)(1)-(2), as a source for interpreting the language, "actually paid or accrued." That regulation governs the year in which foreign taxes are counted towards the FTC limitation. The Federal Circuit applies the two parties' interpretations of 'actually' to the regulation and concludes that the government's view is correct. The court further comments that Congress appears to have taken the key statutory phrase directly from that regulation and presumably meant it to have exactly the same meaning.

Overall, the court relies on the history of the relation-back doctrine set forth in Rev. Rul. 58-55 and *Cuba Railroad*, its interpretation of the reasoning for the 1997 statutory change to Section 6511(d)(3)(A), and the use of the phrase 'actually paid or accrued' in the section 904 regulations, to conclude that the Section 6511(d)(3) statute of limitations should run from the 1998 filing date, not the 2002 filing date.

The court's analysis and conclusions with respect to the 1998 foreign taxes foreshadows its conclusion with respect to the 1997 taxes, which the court very briefly considered. Here, the court notes that the 10-year period ran "from the date prescribed by law for filing the return for the year with respect to which the claim is made." Based on the fact that Albemarle's claim with respect to its 1997 taxable year, the court concluded that the 10-year period had expired by the time that claim for refund had been filed in 2009.

Observation: The Federal Circuit's opinion echoes much of the reasoning of the trial court, and the conclusion is not surprising. The Federal Circuit still counts the 10 years from the same date for Section 905(c) purposes as other authority counts the 10 years for Section 904(c) carryover purposes. Taxpayers potentially affected by this result may want to consider bringing a refund suit in their local federal District Court rather than the Court of Federal Claims. Further, the position taken by the IRS in *Albemarle*, and ultimately by the court, is consistent with the IRS' position in several recently released internal legal memoranda. *See* ILMs 201540010 - 012, all of which were released on October 5, 2015. Of particular note is ILM 2015400012, where the taxpayer missed the 10-year filing period by three weeks, but argued that it made the IRS aware of its intent to file a claim for refund. The ILM specifically addresses the requirements to make a valid claim of refund, and underscores the IRS' strict interpretation of the 10-year period under Section 6511(d)(3)(A). Taxpayers should be mindful of the statute of limitations applicable to claiming a refund attributable to various attributes (particularly FTCs), where a foreign tax dispute with respect to a particular year may not be resolved for several years.

The takeaway

The Federal Circuit in *Albemarle* affirmed that redetermined foreign taxes relate back to the year incurred, not the year in which a foreign jurisdiction finalized the redetermination. The application of Section 6511(d)(3) focuses on the original year to which redetermined foreign taxes relate, rather than the years in which the redetermined payments occur. This result may be important for taxpayers with FTC claims involving contested taxes where the claims have been delayed, whether by the taxpayer or by a foreign taxing authority. Taxpayers potentially affected should take measures where possible, such as filing protective refund claims, to ensure that they can claim any foreign taxes paid as a US FTC.

Let's talk

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

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