

Office of Chief Counsel
Internal Revenue Service
Memorandum

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CC:LB&I: :POSTF-132773-12

date: October 4, 2012

to: , Team Manager, LB&I:
, Revenue Agent: LB&I:

from: , Associate Area Counsel, CC:LB&I:
, Attorney, CC:LB&I:

subject: Protective Claim

Taxpayer: Corporation & Subsidiaries

EIN:

Tax Year Ended: , 1998

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

INTRODUCTION

On July 20, 2012, you requested advice on whether a timely protective claim filed for the Taxpayer's taxable year ended , 1998 ("98 ") is valid for purposes of allowing a reduction of \$ in the amount of the ratable portion of a positive section 481(a) adjustment that the Taxpayer reported on its consolidated U.S. Corporation Income Tax Return ("Form 1120") for 98 .¹ Subsequently, on August 6, 2012, you expanded upon your original request by asking us for our advice on whether the Taxpayer's claim for mitigation filed in a second claim submitted on March ("the Second Claim") is a valid amendment of the Protective Claim and, thus, entitles the Taxpayer to a reduction of the ratable portion of the positive section 481(a) adjustment reported on its 98 Form 1120. This memorandum responds to both requests.

¹ Hereinafter this claim will be referred to as the "Protective Claim."

ISSUES

1. Whether the Taxpayer's timely filed Protective Claim is valid for purposes of allowing a reduction in the amount of the ratable portion of a positive section 481(a) adjustment that the Taxpayer reported on its 98 Form 1120.

2. Whether the Taxpayer's Second Claim should be treated as an amendment to the Protective Claim thereby entitling the Taxpayer to a reduction of the ratable portion of the positive section 481(a) adjustment that the Taxpayer reported on its 98 Form 1120.

CONCLUSIONS

1. No, the Taxpayer's Protective Claim is not valid for purposes of allowing a reduction in the amount of the ratable portion of a positive section 481(a) adjustment that the Taxpayer reported on its 98 Form 1120 because the contingency described and identified therein is not related to the adjustment upon which the positive section 481(a) adjustment is predicated.

2. No, the Second Claim cannot be treated as an amendment to the Protective Claim because the Protective Claim filed was specific in properly identifying and describing the contingency it was seeking to protect against. The Protective Claim may not be amended out of time to seek a refund on account of other, unrelated items.

FACTS

I. The Statutory Notice of Deficiency ("SNOD")

On _____, the Internal Revenue Service ("Service") issued a Statutory Notice of Deficiency ("SNOD") to the consolidated return group Corporation & Subsidiaries ("Taxpayer") for its taxable year ending _____, 1997 ("97"). The Taxpayer petitioned the SNOD to the United States Tax Court ("Tax Court").

The SNOD included an adjustment of \$ _____, labeled as "7.b. Gross income."² This adjustment was itself comprised of two components: (1) An increase to gross income in the amount of \$ _____ to restore to income the aggregate balances of Third Party Payable reserve accounts as of the beginning of 97 ; and, (2) a decrease to gross income in the amount of \$ _____ to allow the aggregate amount of the decreases in the Third Party Payable reserve accounts during 97 .

² Hereinafter, this adjustment will sometimes be referred to as the "Third Party Payable adjustment."

“Third Party Payables” are used by the Taxpayer to track overpayments received from, and due to, fiscal intermediaries for Medicare and .³ In a Stipulation of Settled Issues filed with the Tax Court in October , the government conceded the entire \$ adjustment.

In addition to the foregoing, during its examination of the 97 return, the Service also determined that the Taxpayer should have used amounts calculated by as reserve account balances as of , 1996. As a result of this determination, the SNOD also included an adjustment of \$, labeled as “7.a.”⁴ The \$ was actually comprised of two adjustments: (1) a decrease in the amount of \$ to the ratable portion of a positive section 481(a) adjustment reported by the Taxpayer for 97 ; and (2) a decrease in the amount of \$ to the Taxpayer's claimed deductions for 97 .

II. Tax Court Opinion with respect to Adjustment labeled “7.a.”

In Corp. v. Commissioner, , the Tax Court sustained the adjustment of \$. In so doing, the Court stated, “[w]e sustain respondent’s determination that the reserve account amounts calculated by should be used for purposes of the section 481(a) adjustment.”

As noted by the Tax Court, the reserve amounts calculated by for the three entities included in the Taxpayer's consolidated group that had changed their method of accounting for were \$, \$, and \$, respectively, and using these figures, the ratable portion of the section 481(a) adjustment is \$.

III. Overstated Ratable Portion of Section 481(a) Adjustment for 98

The change in method of accounting for was one for which the Taxpayer was required to take a positive section 481(a) adjustment amount into account ratably over three tax years in computing its taxable income. Using the amounts calculated by as the reserve account balances results in a positive section 481(a) adjustment of \$ (\$ + \$ + \$), so that the ratable portions of the positive section 481(a) adjustment which should have been taken into account by the Taxpayer over each of the three years 97 , 98 and the taxable year ended , 1999 (“99 ”) were \$. The Taxpayer instead had reported the ratable portions of the positive section 481(a) adjustment as \$, \$, and \$ for 97 , 98 and 99 , respectively. Thus, for 98 , the Taxpayer overstated the ratable portion of the positive section 481(a) adjustment by \$ (\$ – \$).

³ Medicaid program is called “ .”

⁴ Hereinafter, this adjustment will sometimes be referred to as the “ adjustment.”

IV. Facts Related to Statute of Limitations to Claim Refund for 98

The Taxpayer filed its Form 1120 for 98 on February 21, . The Taxpayer made remittances to the Service toward its 98 income tax liability before it filed its 98 Form 1120. No payments were made by the Taxpayer toward its 98 income tax liability after the return was filed.

The Service and the Taxpayer executed several consents to extend the statute of limitations on assessment for 98 . The last of these consents extended the period for assessment until December 31, .

V. The Protective Claim for Refund

Attached hereto is the Protective Claim which was timely filed in the form of an Amended U.S. Corporation Income Tax Return ("Form 1120X") on December 16, .

On the front page of the Form 1120X, there is a net decrease to taxable income shown for additional deductions in the amount of \$. On page 2 of the Form 1120X, the Taxpayer states, "INCREASE IN EXPENSES IS DUE TO ADDITIONAL DEDUCTION TAKEN RELATING TO THIRD PARTY PAYABLE."

On the third page of the Protective Claim, the Taxpayer states with specificity the grounds on which it is relying to claim additional deductions -- namely, that if the Tax Court upholds the "net Section 481 adjustment in the amount of \$ relating to a determination made by the IRS that the Taxpayer used an incorrect method of accounting with respect to certain amounts owed to Medicare or Medicaid which are referred to as "Third Party Payables" the Taxpayer would be entitled to a deduction for the amount of Third Party Payable liabilities actually paid to Medicare or Medicaid in 98 in an amount up to, or equal to, \$.⁵ On the third page, the Taxpayer also states that "[t]his protective claim for refund is required as a result of the legal position being taken by the IRS in the case pending before the United States Tax Court at Docket No. ."

The Protective Claim does not mention the adjustment included in the SNOD, or claim that the Taxpayer would be entitled to increase its deductions or decrease its income if the adjustment is upheld by the Tax Court. In addition,

⁵ Stated another way: If the Tax Court upholds the Third Party Payable adjustment set forth in the SNOD (relating to a determination made by the Service that the Taxpayer used an incorrect method of accounting with respect to certain amounts owed to Medicare or Medicaid (i.e., the "Third Party Payables")), the Taxpayer would be entitled to a deduction for the amount of Third Party Payable liabilities actually paid to Medicare or Medicaid in 9804 in an amount up to, or equal to, \$.

on the front page of the Protective Claim, the Taxpayer did not claim that Total income (Form 1120, line 11) should be changed.

The Protective Claim has not yet been acted upon by the Service.

VI. The Second Claim

On March 22, , the Taxpayer filed the Second Claim on which it reported a net decrease to "Total income" of \$. A copy of the Second Claim is attached hereto.

In the "Part I Line 1 Explanation" included in the Second Claim, the Taxpayer states that the statute of limitations to file the Second Claim is open under the mitigation provisions of the Internal Revenue Code (Secs. 1311 - 1314) since the Tax Court decision to which it relates became final on April 10, . The "Part 1 Line 1 Explanation" also states that the Second Claim is timely as an amendment to the Protective Claim. We have previously determined (and CC:PA:06 concurred) that the mitigation provisions do not allow the Taxpayer to reduce its taxable income for 98 by its \$ overstatement of the ratable portion of the positive section 481(a) adjustment. (See advice rendered on July 16, 2012, in TECHMIS Case No. POSTF-123135-12, copy attached.)

In the "Part I Line 1 Explanation," the Taxpayer explains that the result of the Tax Court's "determination ["that the Taxpayer's Section 481(a) adjustment relating to was computed incorrectly resulting in a net disallowance to the Taxpayer's reported for the taxable year ending , 1997 in the amount of \$ "] is a reduction to the Section 481(a) amount reported by the Taxpayer for [98]" totaling \$.

LEGAL ANALYSIS

I. General

In general, the Service is authorized to refund any overpayment of tax to the person who made such overpayment. I.R.C. § 6402. However, under section 6511(b)(1), no refund can be made after the period of limitations for filing a claim for credit or refund has expired unless the taxpayer timely filed a claim for credit or refund. Under section 6511(a), a taxpayer generally has 3 years from the time its return was filed or 2 years from the time the tax was paid, whichever is later, to file a claim for refund.

However, if an agreement is made under section 6501(c)(4) extending the period for assessment of tax, the period for filing a claim for refund does not expire prior to six months after the expiration of the period within which an assessment may be made pursuant to the agreement or any extension thereof under section 6501(c)(4).

II. Protective Claims

The concept of a "protective claim" is not found in the Code or regulations, but is established by case law. Protective claims are formal claims or amended returns for credit or refund normally based on expected changes in the Code, regulations, legislation, or current litigation. See IRM 21.5.3.4.7.3 (10-01-2002). They are recognized by the courts and the Service as a means to file a claim within the time constraints of section 6511, even though the taxpayer's right to the refund is currently contingent and must await resolution, for example, of pending legislation or current litigation. Once the contingency is resolved, the Service may immediately disallow or allow the claim.

A valid protective claim need not state a particular dollar amount or demand an immediate refund. However, the claim must: (1) have a written component; (2) identify and describe the contingencies affecting the claim; (3) be sufficiently clear and definite to alert the Service as to the essential nature of the claim; and (4) identify a specific year or years for which a refund is sought. United States v. Kales, 314 U.S. 186, 194 (1941); Axtell v. United States, 860 F. Supp. 795, 800 (D. Wy. 1994); see also IRM 25.6.1.10.2.6.5(2) (05-17-2004).

III. General and Specific Refund Claims

The Courts distinguish between "general" and "specific" refund claims. General claims assert that an overpayment has occurred, but do not state supporting facts or reasons. See United States v. Andrews, 302 U.S. 517, 524 (1938); United States v. Memphis Cotton Oil Co., 288 U.S. 62, 64-65, 70 (1933). In contrast, "specific" claims identify particular transactions or factual circumstances underlying the refund request. Andrews, 302 U.S. at 524-25.

IV. Amendment to Protective Claim

It should be noted that the amendment of a timely specific claim is treated differently from the amendment of a general claim. A general claim may be amended following the running of the statute of limitations to supply the missing information that caused the claim to be classified as general. See, e.g., Memphis Cotton Oil Co., 288 U.S. at 71.

A claim limited to a specific item may not be amended following the running of the statute of limitations to seek refund on account of other, unrelated items. Andrews, 302 U.S. at 524. Thus, a supplemental claim will not be considered an amendment to the original claim if it would require the investigation of new matters that would not have been disclosed by the investigation of the original claim. Id. at 524 - 26; Pink v. United States, 105 F.2d 183, 187 (2d Cir. 1939). Such a supplemental claim is a new claim, and not an amendment to the timely original claim.

Whether an otherwise untimely, new legal ground for recovery may be introduced by amending a pending timely filed claim depends upon the facts that an investigation of the original claim would disclose. If the facts upon which the amendment is based would necessarily have been ascertained in determining the merits of the original claim, the amendment is proper. Pink, at 187.

A supplemental claim will not generally be considered an amendment to the original claim if the Service took final action on the original claim by either denying or allowing the claim in whole or in part. In either case, the supplemental claim is untimely because once the Service has taken final action on the original claim, there is no longer any claim left to amend. Mondschein v. United States, 338 F.Supp. 786 (E.D.N.Y. 1971), aff'd, 469 F.2d 1394 (2d Cir. 1973); Edwards v. Malley, 109 F.2d 640, 645 (1st Cir. 1940).

DISCUSSION

Issue 1

In the Protective Claim, the Taxpayer identified and described the contingency involved in the claim as the Taxpayer being entitled to an additional deduction relating to amounts actually paid for Third Party Payable liabilities to Medicare or Medicaid in 98 , in amount up to or equal to \$, if the Tax Court were to uphold the "net Section 481 adjustment in the amount of \$ " determined by the Service in the SNOD. Furthermore, on the Protective Claim, the Taxpayer claimed a "Net change" in Taxable income of \$, attributable to an increase in total deductions of \$ "due to additional deduction taken relating to third party payable." The Protective Claim did not advance as a basis for issuance of a refund the potential contingency that the adjustment would be upheld by the Tax Court and therefore, that it would be entitled to decrease "Total income" by \$, or for that matter any other amount, as a result of overstating the ratable portion of its positive section 481(a) adjustment for 98 .

The essential nature of the Protective Claim is that additional deductions should be allowed for Third Party Payables in 98 , if the Service prevails on its position with respect to Third Party Payables in the SNOD. The Protective Claim does not: (1) mention the adjustment in the SNOD; or (2) reflect a contingent decrease to "Total income" to decrease the ratable portion of the section 481(a) adjustment reported for 98 , as previously noted.

The Service's investigation into whether the Protective Claim should be allowed would have required it to only ascertain whether the Service prevailed with respect to the adjustment in the SNOD increasing the Taxpayer's gross income by \$ for 97 . An investigation of the Protective Claim would not have required the Service to determine the resolution of the adjustment in the SNOD and whether the

Taxpayer's ratable portion of the section 481(a) adjustment was overreported in 98 . In other words, for the Service to determine whether a reduction in the ratable portion of the positive section 481(a) adjustment would be appropriate would have required investigation into facts other than those it would have been required to investigate to ascertain whether the Protective Claim should be allowed.

Finally, we note that when the Protective Claim is read as a whole the words "[t]his protective claim for refund is required as a result of the legal position being taken by the IRS in the case pending before the United States Tax Court at Docket No.

" are not sufficient to support a conclusion that the claim notified the Service that changes would be required for 98 if the Service were to prevail on the adjustment. Those words, taken in the context of the entire Protective Claim, and particularly the third page of the Protective Claim, did not provide notification to the Service that the Taxpayer was claiming that there was any potential adjustment for 98 , beside the potential adjustment to increase the deduction relating to the Third Party Payables.

Based on the foregoing, we are of the opinion that the Protective Claim is not valid for purposes of allowing a reduction in the amount of the ratable portion of a positive section 481(a) adjustment reported by the Taxpayer for 98 .

Issue 2

At issue is whether the Second Claim, which was filed on March 22, , can be considered a valid amendment to the timely Protective Claim. If not, it is barred as not timely filed within the time constraints set forth in section 6511, since it was filed more than six months after the period in which an assessment could have been made for 98 pursuant to the final agreement entered into under section 6501(c)(4).

Since the Protective Claim was limited to a specific and identifiable item, it may not later be amended out of time to seek a refund on account of other, unrelated items. See Andrews, 302 U.S. at 524. The grounds relied on in the Second Claim are entirely new and do not merely clarify the grounds relied on in the Protective Claim. The Second Claim is based on different facts than the Protective Claim. An investigation of the Protective Claim would have disclosed facts pertaining to the deduction claimed for Third Party Payables in 98 . However, the Second Claim would have required an investigation into the calculation of the amount of the ratable portion of the positive section 481(a) adjustment reported for 98 due to the change in method of accounting for , which would not have been ascertained in determining the merits of the Protective Claim. Consequently, the Second Claim would have required examination of new matters and different facts.

In light of the above, the Second Claim should not be allowed as an amendment to the Protective Claim to entitle the Taxpayer to a reduction of the ratable portion of the

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positive section 481(a) adjustment that the Taxpayer reported on its 98 Form 1120. The Second Claim is a new claim, barred as not timely filed.

Should you have any questions regarding the above or need further assistance, please contact _____ of our office at _____ .

2 Forms 1120X were withheld in full