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Internal Revenue Service National Office Chief Counsel Advice

DATE: January 11, 1999

TO: Team Coordinator

FROM: Michael D. Finley  
Chief, Branch 3 CC:DOM:IT&A:3

SUBJECT:

This advice responds to your telephone inquiry, as supplemented by a copy of a memorandum, dated December 7, 1998, describing the facts of the case. This advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

The taxpayer =  
Years 1-10 =

ISSUE:

When the carryback of a net operating loss under § 172 has the effect of creating or increasing an investment tax credit or foreign tax credit carryover to a year following the carryback year, is a refund allowable under § 6511(d)(2) for the year to which the credit is carried, if that year is otherwise barred?

CONCLUSION:

Yes. A refund for the year to which the investment tax credit or foreign tax credit is carried is allowable because the overpayment is "attributable to a net operating loss carryback" within the meaning of § 6511(d)(2).

The position to the contrary taken by the Government in Marshalltown Savings & Loan Ass'n v. U.S., 92-1 USTC ¶ 50,100; 69 AFTR2d ¶ 92-383 (SD Iowa 1991), is incorrect and should not be followed.

#### FACTS:

The taxpayer, a commercial bank within the meaning of §§ 585(a)(2) and 172(b)(2)(D), filed a Form 1139, "Corporation Application For Tentative Refund," subsequently perfected by a regular refund claim on Form 1120X, carrying back a net operating loss attributable to a bad debt deduction from Year 10 to Years 3 and 4, as permitted under § 172(b)(2) for the years in question.

The net operating loss carryback did not result in refunds for Years 3 and 4. Instead, the net operating loss deductions in Years 3 and 4 reduced the taxpayer's taxable income and its tax for those years -- not counting investment and foreign tax credits -- to zero. This had the effect of creating or increasing the carryforward of unused investment tax credits and foreign tax credits, which became available for Years 5 and 6, creating overpayments in those years.

At the time the taxpayer claimed refunds for Years 5 and 6, the special period of limitations for refunds attributable to a net operating loss was open, with respect to the net operating loss that was sustained in Year 10. However, the general refund periods for Years 5 and 6 had expired.

#### LAW AND ANALYSIS:

Under § 6511(a), the general period of limitations on credit or refund is three years from the time the return was filed or two years from the time the tax was paid, whichever expires later.

A special period of limitations is provided in §6511(d)(2), however, which provides that if the claim "relates to an overpayment attributable to a net operating loss carryback," in lieu of the period in § 6511(a) the period shall be the period that ends three years after the time for filing the return for the year of the net operating loss that results in the carryback.

In Marshalltown Savings & Loan Ass'n v. United States, 92-1 USTC ¶ 50,100; [AFTR cite] (S.D. Iowa 1991), the taxpayer filed a Form 1139 and a Form 1120X for 1980, based on the carryback of a net operating loss from 1985 to 1979, and a resultant carryforward of investment tax credits from 1979 to 1980. The court held that although the general refund limitations period had expired for 1980, the taxpayer's refund claim was timely under § 6511(d)(2).

In First Chicago Corp. v. Commissioner, 742 F.2d 1102 (7th Cir. 1984), rev'g 80 T.C. 648 (1983), the taxpayer claimed and was allowed a capital loss carryback and an investment credit carryback from 1974 to 1971. The Service later determined a deficiency in tax for 1972, based on the fact that the taxpayer had not adjusted its minimum tax carryover for 1972 to take into account the decrease in its 1971 income tax caused by the carrybacks. At the time the Service issued the notice of deficiency for 1972, the general period of limitations for assessment under § 6501(a) had expired. Adopting the dissenting Tax Court opinion, the Seventh Circuit held that the notice of deficiency was timely under § 6501(h) and (j).<sup>1</sup>

In his dissenting opinion in First Chicago, Tax Court Judge Whitaker rejected the majority's view that the Service was seeking to reopen a barred year unrelated to the carryback year: Instead, the 1972 adjustment was "an automatic mechanical adjustment due directly to the 1971 carryback." 80 T. C. at 664. Finding the majority opinion too narrow in limiting the scope of § 6501(h) and (j) to the carryback year, Judge Whitaker held that the deficiency was "attributable to" the carryback, within the meaning of those provisions, so long as it could be "traced directly to" the carryback. Id. at 665, 671, citing Herman Bennett Co. v. Commissioner, 65 T.C. 506 (1975). Neither the failure of the relevant legislative history to discuss a situation other than a deficiency in the carryback year, see id. at 669; the fact that a "carryover" (rather than a carryback) was involved, see id. at 671; nor a negative inference from the fact that provisions such as § 6501(j) specifically refer to carrybacks that are attributable to other carrybacks, see id. at 661-63 (concurring opinion), persuaded the dissent to adopt a different interpretation.

Although the First Chicago case concerned the assessment limitations period, rather than the refund limitations period, the provisions at issue here and in the Marshalltown case are generally in pari materia with the provisions at issue in First Chicago. In the absence of countervailing factors, they should receive a similar interpretation. In the present case, as in First Chicago and Marshalltown, the overpayments in Years 5 and 6 caused by the increased investment tax and foreign tax credits can be "traced directly to" the net operating loss carryback from Year 10. Moreover, the taxpayer was not entitled to those overpayments until the net operating loss was sustained, at which point

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<sup>1</sup> Section 6501(h) provides that in the case of a deficiency "attributable to the application to the taxpayer of a net operating loss carryback or a capital loss carryback," the deficiency may be assessed at any time before the expiration of the period within which a deficiency for the year of the net operating loss or net capital loss may be assessed. Section 6501(j) provides a similar rule for a deficiency "attributable to the application to the taxpayer of a credit carryback."

the general refund period of limitations for Years 5 and 6 had expired, and -- since there is no tax liability for Years 3 and 4 in any case -- the taxpayer will lose the benefit of the net operating loss to the extent it cannot obtain refunds for Years 5 and 6. See also Rev. Ruls. 71-534, 1971-2 CB 414; 82-172, 1982-2 CB 397 (analogous reasoning applied in determining overpayment and underpayment interest under §§ 6611(f) and 6601(d); net operating loss is the “significant event” that gives rise to the interest adjustment).

In view of these considerations, we believe that the opinion of the court in Marshalltown -- rather than the position taken by the Government in that case -- reflects the better interpretation of § 6511(d)(2). Accordingly, in the present case the overpayments in Years 5 and 6 are “attributable to a net operating loss carryback” within the meaning of § 6511(d)(2), and refunds for those years are allowable.

If you have any further questions, please call the branch telephone number.

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By: \_\_\_\_\_  
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