



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Pamela W. Fuller
Senior Technician Reviewer
Administrative Provisions & Judicial Practice CC:PA:APJP:1

SUBJECT: POSTF-151475-01

This Chief Counsel Advice responds to your memorandum dated November 16, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

- Company =
- Year 1 =
- Year 2 =
- Year 3 =
- Year 4 =
- Year 5 =
- Year 7 =
- \$A =
- \$B =
- \$C =
- \$D =
- \$E =
- \$F =
- \$G =
- \$H =
- \$I =
- \$J =

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<u>\$K</u>	=
<u>\$L</u>	=
<u>\$M</u>	=
<u>\$N</u>	=
<u>\$O</u>	=
<u>\$P</u>	=
<u>\$Q</u>	=
<u>\$R</u>	=
<u>\$S</u>	=
<u>\$T</u>	=
<u>\$U</u>	=
<u>\$V</u>	=
<u>\$W</u>	=

ISSUES

We have restated the issues as follows:

- (1) What portion of Company's request for accelerated refunds is reviewed by the Joint Committee on Taxation under section 6405 of the Internal Revenue Code.¹
- (2) If Company is entitled to an accelerated refund that is reviewed by the Joint Committee on Taxation, does Company's proffered security, consisting of Company's unregistered common stock, constitute collateral that adequately protects the interest of the United States.
- (3) If Company is entitled to credits under section 34, does Company's request for accelerated refunds attributable to these credits satisfy the requirements of Revenue Ruling 54-378.

CONCLUSIONS

(1) Pursuant to section 6405, certain credits and refunds in excess of \$2,000,000 are reviewed by the Joint Committee on Taxation. The Committee will review section 34 credits to the extent that they do not exceed the amount of income tax paid (reduced by any other credits claimed) by the taxpayer in the tax year in which the credit arose if the aggregate amount of section 6405(a) claims exceed \$2,000,000. As explained below, Company's section 34 claims and non-section 34 claims do not exceed the total income

¹Unless noted otherwise, all references are to the Internal Revenue Code.

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tax paid by Company in each of the years in which the refund claims arose.² Because the aggregate amount of the section 34 and non-section 34 claims do not exceed the amount of income tax paid, the section 34 claims constitute claims reviewed by the Joint Committee on Taxation. As a result, the entire claim constitutes a refund claim which is reviewed by the Joint Committee as the aggregate amount of those claims, \$C, exceeds \$2,000,000.

(2) Company's proffered security, outlined in its trust agreement, does not constitute adequate collateral for issuing accelerated refunds and does not adequately protect the interest of the United States. This collateral, comprised of Company's unregistered common stock, is inadequate for the following reasons: 1) The value of Company's common stock may decrease in the event that Company incurs future tax liabilities; 2) The applicable trust agreement does not automatically provide for payment of Company's tax liability to the Service; 3) The trustee has the right to sell Company's stock only after Company provides certification of a final settlement or determination of Company's federal tax liability; 4) Company is under no obligation to add additional property to the trust if the value of the stock declines; 5) The stock will not be registered with the Securities and Exchange Commission or on Company's records of stock ownership; 6) The stock can not be sold until it is registered as required by the Securities and Exchange Commission; 7) Company's bylaws state that Company is not required to recognize any equitable or other claim to, or interest in, any stock unless a transfer of stock is made on Company's books, or the holder of stock files a power of attorney to transfer stock with and surrender stock certificates to Company's authorized transfer agent. As a result, Company's collateral inadequately protects the Service's ability to recover erroneously paid accelerated refunds, thereby placing the risk of nonpayment on the Service.

(3) All of the refund claims are subject to review by the Joint Committee on Taxation, therefore Revenue Ruling 54-378 does not apply.

FACTS

Company has not filed any formal refund claims or Forms 1120X for tax years ended June 30, Year 1 through June 30, Year 5. However, in October of Year 7, Company provided the Service with a document that reflected tentative reductions in income tax and requested accelerated refunds. Company claims fuel tax credits, under section 34, for tax years ending June 30, Year 2 through June 30, Year 5 in the amount of \$A. Company also claims non-section 34 income tax credits in the amount of \$B. Company's income tax payments and claims consist of the following amounts:

² The term, claims is used because a taxpayer plans on using a bonding procedure that will allow it to obtain refunds prior to the conclusion of an audit.

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<u>Year</u>	<u>Total Income Tax Paid</u>	<u>Non §34 Claims</u>	<u>§34 Claims</u>	<u>Total Claims</u>
1	<u>\$E</u>	<u>\$J</u>	<u>\$O</u>	<u>\$J</u>
2	<u>\$F</u>	<u>\$K</u>	<u>\$P</u>	<u>\$T</u>
3	<u>\$G</u>	<u>\$L</u>	<u>\$Q</u>	<u>\$U</u>
4	<u>\$H</u>	<u>\$M</u>	<u>\$R</u>	<u>\$V</u>
5	<u>\$I</u>	<u>\$N</u>	<u>\$S</u>	<u>\$W</u>
<u>Totals</u>		<u>\$B</u>	<u>\$A</u>	<u>\$C</u>

Company has requested an accelerated refund in the amount of \$C which includes the section 34 claims. The Service has not determined Company's entitlement to any items that underlie the request for the accelerated refund. The Service has not examined Company's Forms 1120 for tax Years 1 through 5. The applicable limitation periods for filing refund claims remain open because Company and the Service executed Consents to Extend the Time to Assess Tax (Forms 872).

Company's proposed collateral for the accelerated refund consists of treasury shares of Company's common stock without voting and dividend rights. This stock is to be placed in an irrevocable trust subject to state law. An independent commercial bank is to act as trustee. The stock will not be registered with the Securities and Exchange Commission or on Company's records of stock ownership. Under Company's bylaws, Company is not required to recognize any equitable or other claim to or interest in any stock of any person unless a transfer of stock is made on Company's books, or the holder of stock files a power of attorney to transfer stock with and surrender stock certificates to Company's authorized transfer agent.

The value of the initial shares of stock placed in the trust are to cover both the amounts of tax refunded and the amount of any potential underpayment interest agreed to by Company and the Service by reference to the 52-week low price of the registered, trading Company common stock reported in the Wall Street Journal at approximately the time of the transfer to the trust. Among other requirements, the stock cannot be sold until it is registered as required by the Securities and Exchange Commission, and the trustee has the right to sell the stock only after Company provides certification of a final settlement or determination of Company's federal tax liability. If the value of the assets placed in the trust subsequently does not equal the greater of the initial value of the stock placed in trust or the income tax liability, Company may add additional monies or property (including additional shares of Company's common stock) to the trust res.

Company has not provided the Service with its financial statements for the third quarter of Year 7, therefore, Company's current assets and liabilities are unknown. In addition, Company's debt ratings have declined. As of October 18, Year 7, Company has no

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unpaid, assessed federal tax or other liabilities that may offset or reduce overpayments under section 6402.

LAW AND ANALYSIS

Issue (1): What portion of Company's request for accelerated refunds is reviewed by the Joint Committee on Taxation under section 6405.

Section 6402(a) provides that the Secretary, within the applicable period of limitations, may credit the amount of any overpayment against any internal revenue tax liability on the part of the person who made the overpayment and shall, subject to subsections (c), (d), and (e), refund any balance to such person.³ Section 301.6402-1 of the Regulations on Procedure and Administration provides, in part, that the Commissioner may credit any overpayment of tax, including interest thereon, against any outstanding liability for any tax owed by the person making the overpayment.

Section 6401 provides that overpayments include any amounts paid in respect to an internal revenue tax that is assessed or collected after the applicable period of limitations; any amount of allowable credits under sections 31 through 35 that exceed the tax imposed by subtitle A; and amounts erroneously overpaid as a tax. An overpayment includes the amount of the taxpayer's liability for a tax period or any amount that was assessed or collected after the expiration of the applicable period of limitations. I.R.C. § 6401; Jones v. Liberty Glass Co., 332 U.S. 524 (1948). The Service is not required or authorized by statute to refund tax payments claimed by a taxpayer if an overpayment has not been determined. Lewis v. Reynolds, 284 U.S. 281 (1932). Refund claims submitted pursuant to Treas. Reg. §§ 301.6402-2 and 3, do not, in themselves, provide a basis for making a refund of tax, until the Service determines that an overpayment exists and that the taxpayer is entitled to the refund.

In general, the Service does not make refunds of tax, unless it has first determined that there is an overpayment of tax to be refunded. Two exceptions to this rule are Treas. Reg. § 301.6402-4 and section 6411. Under Treas. Reg. § 301.6402-4, if an overpayment is claimed on the taxpayer's return to recover payments made before the return was filed, the Service may credit or refund payments in excess of the amount shown on the return without awaiting examination of the completed return and without awaiting filing of a claim for refund. Under section 6411 and the regulations thereunder, a taxpayer may apply for a tentative carryback adjustment of tax for a prior taxable year affected by certain carrybacks from another taxable year if the application is filed within twelve months after the source year in which the loss or credit to be carried back arose.

³ Subsections (c), (d), and (e) respectively address: offset of past due support against overpayments, collection of debts owed to federal agencies, and collection of past due, and legally enforceable state income tax obligations.

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Under section 6411, the Service makes a limited review of the application only for material omissions and computational errors before either disallowing the application or making a tentative refund. See Treas. Reg. § 1.6411-3(b).

If the Service determines that there is an overpayment in excess of \$2,000,000, the Service may not refund or credit the overpayment unless it also satisfies the additional requirements under section 6405(a). Section 6405(a) provides that no refund or credit of any income, war profits, excess profits, estate, or gift tax, or any tax imposed with respect to public charities, private foundations, operators' trust funds, pension plans, or real estate investment trusts under chapter 41, 42, 43, or 44, in excess of \$2,000,000 shall be made until after the expiration of 30 days from the date upon which a report... is submitted to the Joint Committee on Taxation.

There are four types of reports that can be submitted to the Joint Committee. In this case, the Service would need to submit a "modified expedite refund report." The "modified expedite refund report" is the mechanism for seeking approval for an expedited refund without waiting until all issues affecting the tax period have been resolved.

The following conditions must be met before a "modified expedite refund report" can be prepared and sent to the Joint Committee:

- 1) There must be a claimed section 6405(a) refund in excess of \$2,000,000 in an unexamined or unsurveyed source or carryback year. IRM 4.3.5.6.5.1;
- 2) The examination or survey action will not be completed within six months from the date the taxpayer requested the refund be made. IRM 4.2.5.6.5.1;
- 3) The taxpayer must provide the Service with an irrevocable bank letter of credit or a surety bond prior to payment of the unexamined claim;
- 4) The report must set forth the information required by IRM 4.3.5.6.5.2; and
- 5) A supplemental report must be submitted at the end of the examination or survey of the source years. IRM 4.3.5.6.5.4.

For purposes of section 6405(a) and Joint Committee review, the determination of whether section 34 claims will be reviewed by the Joint Committee depends on the amount of income tax paid by the taxpayer in the tax year in which the section 34 claims arose and the total amount of claims to which the taxpayer is entitled under section 34 and otherwise. The Joint Committee will take section 34 claims into account in determining whether the \$2,000,000 threshold is met to the extent that the claims under section 34 do not exceed the income tax paid reduced by claims not attributable

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to section 34 claims. If the aggregate of the amount of section 34 claims and other claims exceed \$2,000,000, a report must be submitted to the Joint Committee.

The amount of section 34 claims that are reviewed are determined as follows:

1) Ascertain the amount of income tax paid in the tax year in which the section 34 claim arose; 2) Reduce the amount of income tax paid in the tax year in which the section 34 claim arose by the amount of claims that are applied to that year's income tax module before any section 34 claims are applied; 3) Reduce further the amount of income tax paid (but not below zero) in the year in which the section 34 claims arose by the amount of section 34 claims. If the total of the amounts determined under steps 2 and 3 exceed \$2,000,000, a report must be submitted to the Joint Committee. For example, assume taxpayer has claims for non-section 34 income tax credits of \$1,000,000, section 34 claims of \$7,000,000, and paid income tax in the amount of \$4,000,000. Further, assume that the \$1,000,000 of non-section 34 claims are to be applied to taxpayer's income tax module before the section 34 claims are to be applied. The \$1,000,000 of non-section 34 claims reduce the income tax module from \$4,000,000 to \$3,000,000. Three million dollars out of the \$7,000,000 of the section 34 claims reduce the income tax module to zero. \$3,000,000 of the section 34 claims and the \$1,000,000 of the non-section 34 claims are reviewed by Joint Committee. The remaining \$4,000,000 of section 34 claims are not reviewed by Joint Committee.

Assuming the amount of Company's refund claims is accurate, the entire amount, \$C, will be reviewed by the Joint Committee on Taxation. In Year 1, Company paid income tax totaling \$E, claimed non-section 34 refunds totaling \$J, and claimed refunds under section 34 totaling \$O. The aggregate of \$J and \$O equal \$J. \$J is an amount that is less than \$E, therefore the entire amount of \$J is reviewed by Joint Committee.

In Year 2, Company paid income tax totaling \$F, claimed non-section 34 refunds totaling \$K, and claimed refunds under section 34 totaling \$P. The aggregate of \$K and \$P equal \$T. \$T is an amount less than \$F, therefore the entire amount of \$T is reviewed by Joint Committee.

In Year 3, Company paid income tax totaling \$G, claimed non-section 34 refunds totaling \$L, and claimed refunds under section 34 totaling \$Q. The aggregate of \$L and \$Q equal \$U. \$U is an amount less than \$G, therefore the entire amount of \$U is reviewed by Joint Committee.

In Year 4, Company paid income tax totaling \$H, claimed non-section 34 refunds totaling \$M, and claimed refunds under section 34 totaling \$R. The aggregate of \$M and \$R equal \$V. \$V is an amount less than \$H, therefore the entire amount of \$V is reviewed by Joint Committee.

In Year 5, Company paid income tax totaling \$I, claimed non-section 34 refunds totaling \$N, and claimed refunds under section 34 totaling \$S. The aggregate of \$N and \$S

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equal \$W. \$W is an amount less than \$I, therefore the entire amount of \$W is reviewed by Joint Committee.

The aggregate of \$J, \$T, \$U, \$V, and \$W equal \$C. \$C is an amount that is greater than \$2,000,000, therefore the entire amount of claimed refunds, \$C, will be reviewed by the Joint Committee on Taxation under section 6405.

Issue (2): If Company is entitled to an accelerated refund that is reviewed by the Joint Committee on Taxation, does Company's proffered security, consisting of Company's unregistered common stock, constitute collateral that adequately protects the interest of the United States.

Section 7101 provides in part that "whenever... a person is required to furnish a bond or security, such bond or security shall be in such form and with such surety or sureties as may be prescribed by regulations issued by the Secretary." The Service has broad discretion to accept a security under section 7101 and may even accept security that may decline in value, such as common stock.

Aside from drawing a distinction between bonds and securities, section 7101 does not define the term security.⁴ Except for one reference, the accompanying regulations deal with bonds, not securities. The one exception is in Treas. Reg. § 301.7101-1(b)(4), which states, no surety or security shall be accepted if it does not adequately protect the interest of the United States. While the regulation does not explicitly state that the Service has broad discretion in determining the adequacy of a particular security and may accept a security that could decline in value, the inference from this regulation points to broad discretion.

In discussing bonds, the regulation explicitly provides that the Service has discretion to accept a bond that is secured by a variety of methods in which the collateral may decrease in value. The Service may accept a bond that is secured by a mortgage on the taxpayer's real or personal property. Treas. Reg. § 301.7101-1(b)(2)(iii). Similarly, the Service may accept a bond secured by corporate bonds or stock. Treas. Reg. § 301.7101-1(b)(2)(v). Finally, the Service may accept a bond "secured by any other acceptable collateral," and there is no suggestion that acceptable collateral could not decline in value. Treas. Reg. § 301.7101-1(b)(2)(vi).

Given that the Service may accept bonds secured by assets that may decline in value, there is no reason to impose a different standard for securities. Accordingly, the Service has broad discretion to accept securities that may decline in value, including

⁴ In part, the statute states, "(w)henever, pursuant to the provisions of this title, a person is required to furnish a bond or security..." The use of the disjunctive "or" in the phrase "bond or security" indicates that a bond is not a security; otherwise, the terms would be redundant.

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common stock. In other words, the concept of security is not limited to instruments through which payment is absolutely guaranteed (e.g., federal bonds). The determination as to whether to accept a security in any given case rests with the Service's prudent judgment.

Company's proffered security, outlined in its trust agreement, does not constitute adequate collateral for issuing accelerated refunds and does not adequately protect the interest of the United States. This collateral, comprised of Company's unregistered common stock, is inadequate for the following reasons: 1) The value of Company's common stock may decrease in the event that Company incurs future tax liabilities; 2) The trust agreement does not automatically provide for payment of Company's tax liability to the Service; 3) The trustee has the right to sell Company's stock only after Company provides certification of a final settlement or determination of Company's federal tax liability; 4) Company is under no obligation to add additional property to the trust if the value of the stock declines; 5) The stock will not be registered with the Securities and Exchange Commission or on Company's records of stock ownership; 6) The stock can not be sold until it is registered as required by the Securities and Exchange Commission; 7) Company's bylaws state that Company is not required to recognize any equitable or other claim to, or interest in, any stock unless a transfer of stock is made on Company's books, or the holder of stock files a power of attorney to transfer stock with and surrender stock certificates to Company's authorized transfer agent. As a result, Company's collateral inadequately protects the Service's ability to recover erroneously paid accelerated refunds, thereby placing the risk of nonpayment on the Service.

Although the Service should not accept Company's proposal, there may be other situations in which the Service may conclude that a taxpayer's stock may qualify as a security. However, it may be very difficult for a corporate taxpayer in financial distress wishing to utilize its stock as collateral to meet the standard that any security arrangement adequately protect the interest of the United States.

Issue (3): If Company is entitled to credits under section 34, does Company's request for accelerated refunds attributable to these credits satisfy the requirements of Revenue Ruling 54-378.

Revenue Ruling 54-378, 1954-2 C.B. 246, allows for the acceleration of partial allowances of refunds and credits in cases where the refunds and credits are not reviewed by the Joint Committee on Taxation. All of Company's refund claims are reviewed by the Joint Committee on Taxation, therefore Revenue Ruling 54-378 does not apply.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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Please call (202) 622-4910 if you have any further questions.