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subject: Protective Claims

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LEGEND

Year X =
Year Y =
Court Opinion =

ISSUES

Whether the Internal Revenue Service (Service) should treat Forms 843, Claim For Refund and Request for Abatement, filed as protective claims and requesting a nominal refund of \$1 as having continuing effect, even though the Service has refunded or processed credit transfers for the \$1 overpayment requested by Taxpayer.

CONCLUSIONS

The protective claims filed by Taxpayer should be treated as having continuing effect, because the Service has not taken final action on those claims. The Service should treat the refunds or processed credit transfers as a partial allowance on the pending protective claims.

FACTS

Taxpayer filed a series of Form 843 claims requesting a refund of \$1. Each Form 843 contained an explanation substantially as follows:

This is protective refund claim intended to suspend the statute of limitations. The total FICA taxes (plus interest) to be refunded for the four quarters in Year Y is far greater than \$1.00. Please see the attached Memorandum in Support of Protective Refund Claims. The tax returns for the FICA taxes at issue were filed on or before the following January 31st. Accordingly, the claim for refund is timely filed. See Code Section 6511(a) and Revenue procedure 81-69, 1981-2 C.B. 726. Additional information relating to individual workers names and Social Security numbers can be provided upon request.

A memorandum attached to the Forms 843 explained the basis for Taxpayer's refund claims. The claims are based on Court Opinion, for which the appeal period has not yet begun to run. The Service campus identified 17 different claims of this type. Of those claims, the Service suspended action on eight claims filed for Year X and treated them as protective claims. The Service refunded or did credit transfers for the \$1 shown on the remaining nine claims filed for Year Y.

Ogden Campus personnel ask if they can treat the nine claims filed for Calendar Year Y as having continuing effect even though the Service processed the Forms 843 and made the nominal refunds or credit transfers. If the Service can treat the nine claims as having continuing effect, Ogden personnel ask what the Service should do about the refund of credit transfers of \$1 per claim.

LAW AND ANALYSIS

Section 6402(a) of the Internal Revenue Code (Code) provides that in the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax 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.

Section 6511(a) of the Code provides that a claim for credit or refund of an overpayment of any tax in respect of which the taxpayer is required to file a return shall be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever of such periods expires later, or if no return is filed by the taxpayer, within two years from the time the tax was paid.

Section 6511(b)(1) of the Code provides that no credit or refund shall be allowed or made after the expiration of the period of limitation prescribed in section 6511(a), unless a claim for credit or refund is filed by the taxpayer within such period.

Section 7422(a) of the Code provides that no suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

Section 301.6402-2(b)(1) of the Regulations on Procedure and Administration provide that no refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim before the expiration of such period. The claim must set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof. The statement of the grounds and facts must be verified by a written declaration that it is made under penalties of perjury. A claim which does not comply with this paragraph will not be considered for any purposes as a claim for refund or credit.

Section 301.6402-3(a)(5) provides that a properly executed individual, fiduciary, or corporation original income tax return or an amended return (on 1040X or 1120X if applicable) constitutes a claim for refund or credit within the meaning of section 6402 and section 6511 for the amount of the overpayment disclosed by such return (or amended return). A return or amended return shall constitute a claim for refund or credit if it contains a statement setting forth the amount determined as an overpayment and advising whether such amount shall be refunded to the taxpayer or shall be applied as a credit against the taxpayer's estimated tax for the taxable year immediately succeeding the taxable year for which such return (or amended return) is filed.

Protective Claims

Protective claims are filed to preserve the taxpayer's right to claim a refund when the taxpayer's right to the refund is contingent on future events and may not be determinable until after the statute of limitations expires. The Internal Revenue Manual (IRM) provides that 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), Protective Claims. The concept of a "protective claim" is not used in the Code or regulations, but is established by case law. See, e.g., *United States v. Kales*, 314 U.S. 186, 194 (1941); *Bokum v. Commissioner*, 992 F.2d 1136, 1139-40 (11th Cir. 1993); *Cooper v. United States*, 99-2 U.S.T.C. ¶ 50,877 (W.D.N.C. 1999); *Axtell v. United States*, 860 F. Supp. 795, 799-801 (D. Wy 1994); *Pickett v. United States*, 90-2 U.S.T.C. ¶ 60,030 (N.D. Fl 1990); *Kellogg-Citizens National Bank of Green Bay v. Estate of Holzer*, 165 Ct. Cl. 452 (1964).

A valid protective claim need not state a particular dollar amount or demand an immediate refund; however, the claim must have a written component, must identify and

describe the contingencies affecting the claim; must be sufficiently clear and definite to alert the Service as to the essential nature of the claim; and must identify a specific year or years for which a refund is sought. See, e.g., *Kales*, 314 U.S. at 194; *Axtell*, 860 F. Supp. at 799-801.

IRM 25.6.6.5.5(3) (05-17-2004) provides:

The Service has discretion in deciding how to process protective claims. In general, it is in the interests of the Service and taxpayers to delay action on protective claims until the pending litigation or other contingency is resolved. Once the contingency is resolved, the Service may obtain additional information necessary in processing the claim and then allow or disallow the claim.

In this case, the pending litigation is not yet resolved because the appeal period has not yet begun to run on Court Opinion. Thus, because Taxpayer's claims are contingent on the final outcome of Court Opinion, Taxpayer's claims are protective claims.

Final Action on a Refund Claim

A supplemental claim filed after the expiration of the statute of limitations is not timely if the Service had previously taken final action on the original claim. Such final action generally occurs when the Service denies or allows the claim. 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. The Supreme Court has held that an amendment is too late after the Service has disallowed the claim. *United States v. Memphis Cotton Oil Co.*, 288 U.S. 62, 72 (1932). In *New York Trust Co. v. United States*, 87 F.2d 889 (2d Cir. 1937), *cert. denied*, 301 U.S. 704 (1937), the appeals court stated:

Allowance of a specific claim and payment of the full sum claimed must be deemed final action thereon, leaving nothing pending for subsequent amendment. No reason is apparent to differentiate between allowance and rejection in this respect, and concededly it is too late to amend after rejection of a claim.

87 F.2d at 891. Accordingly, the Second Circuit upheld the district court's order dismissing the petition for lack of jurisdiction.

In *Mondschein v. United States*, 338 F. Supp. 786 (E.D.N.Y. 1971), *aff'd*, 469 F.2d 1394 (2d Cir. 1973), the district court held that the allowance of the refund claim in full barred the amendment, and thus, the refund claim could not be considered an amendment of a timely claim for statute of limitation purposes. The court then concluded that it had no jurisdiction to entertain the refund action because no refund claim had been duly filed. It reasoned that to be duly filed, a refund claim must be filed within the applicable period of limitations; a tardy claim cannot be grounds for jurisdiction of a refund suit. Since the

taxpayer's second claim was not an amended claim, it must be considered a new and ordinary claim barred by the statute of limitations.

Similarly, in *Union Pacific R.R. Co. v. United States*, 389 F.2d 437 (Ct. Cl. 1968), the Court of Claims held:

The disposition of a taxpayer's refund claim by allowance of the amount requested in full, however, precludes an amendment asserting an additional amount after the expiration of the statutory period for refund. This amendment is effectively a new claim barred by the provisions of section 6511(a) of the Internal Revenue Code of 1954. [The attempted amendment], therefore, is a new claim and not an amendment founded upon a timely claim.

389 F.2d at 447.

See also, *Tobin v. Tomlinson*, 310 F.2d 648 (5th Cir. 1962); *Young v. United States*, 203 F.2d 686 (8th Cir. 1953); *Edwards v. Malley*, 109 F.2d 640 (1st Cir. 1940); *New York Trust Co. v. United States*, 87 F.2d 889 (2d Cir. 1937);

Mutual Assurance, Inc. v. United States, 56 F.3d 1353 (11th Cir. 1995), should not be considered an impediment to treating the protective claims for Year Y as having continuing effect. In *Mutual Assurance*, the taxpayer filed a timely claim for refund in the amount of \$ 495,728 for its 1987 tax year. Taxpayer based the claim on a retroactive election under Rev. Proc. 91-21, 1991-1 C.B. 525, to compute the present value of its unpaid loss reserves using a special schedule of discount factors. Without audit, the Service allowed the taxpayer's claim for refund in full and paid the amount of \$ 485,728 plus interest to the taxpayer. After the expiration of the three year refund period for 1987, the Service, pursuant to a field examination, discovered a miscalculation of the taxpayer's present value of its unpaid loss reserves for the 1987 tax year. This miscalculation had caused the taxpayer to understate the amount of its overpayment in the original claim for refund.

The taxpayer then filed an additional claim for refund for 1987. The Service disallowed the additional claim determining that it had not been filed timely. The taxpayer filed suit and the district court concluded that the later claim for refund amended the earlier claim, which was timely. Thus, the district court held that the taxpayer was entitled to a refund of the additional amount. The Court of Appeals for the Eleventh Circuit affirmed the district court's decision. The Court of Appeals for the Eleventh Circuit held that a supplemental claim for an additional amount was a timely amendment, rather than a new claim barred by the statute of limitations.

The Service disagreed with the holding in *Mutual Assurance* and issued an Action on Decision. In AOD 1999-014, 1999 AOD LEXIS 11, the Service stated,

... we disagree with the decision of the court in *Mutual Assurance*, although we recognize the precedential effect of the decision to cases appealable to the Eleventh Circuit, and, therefore, will follow it with respect to cases within that circuit, if the opinion cannot be meaningfully distinguished. The *Mutual Assurance* original claim contained all the information which would have justified the amount of refund contained in the amended claim, see fn. 2; thus, the case may be limited to that situation in the Eleventh Circuit.

Based on the facts of this case, we don't believe a court will find that the Service has taken final action on Taxpayer's claims. Although the Service refunded or credited the \$1 shown on the nine claims filed for Year Y, those claims stated that the total FICA taxes, plus interest, to be refunded for the four quarters in Year Y is greater than \$1. The claims also stated that additional information relating to the individual worker's names and Social Security Numbers would be provided upon request. Accordingly, payment or credit of the \$1 nominal amount cannot be considered the allowance of the claim in full or final action by the Service. The protective claims filed by Taxpayer should be treated as continuing effect, because the Service has not taken final action on those claims.

Mutual Assurance is distinguishable with the facts in this case. In particular, the original claims in *Mutual Assurance* provided the Service with all the information needed to accurately compute the correct amount of the refund, see 56 F.3d at 1357 fn 2. In the protective claims for Year Y, the Service does not have sufficient information to compute the correct amount of the overpayment.

CONCLUSION

The protective claims filed by Taxpayer should be treated as continuing effect, because the Service has not taken final action on those claims. Those claims stated that the total FICA taxes, plus interest, to be refunded for the four quarters in Year Y is far greater than \$1.00. Accordingly, payment or credit of the \$1.00 nominal amount cannot be considered the allowance of the claim in full or final action by the Service. *Mutual Assurance* is distinguishable because, in these protective claims, the Service does not have sufficient information to compute the correct amount of the overpayment. The Service should treat the refunds or processed credit transfers as partial allowance on the pending protective claims.

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