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NAVIGATING THE STATUTE OF LIMITATIONS MAZE IN THE FEDERAL INCOME TAX ARENA

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I. INTRODUCTION

Individual taxpayers frequently realize that a tax return filed with the IRS needs to be changed for various reasons that may include: previously estimated amounts may later be discovered to have been in error, prior ignorance may have been rectified, or new interpretations of law may have been rendered by the courts or the IRS. The need to adjust a previously filed return may be discovered in the year of filing, or several years later.

State and federal laws generally create statutes of limitation that let the parties to litigation know when the deadlines for bringing the suit expire. Sometimes these statutes are procedural or jurisdictional, such that the court has no jurisdiction to hear the case if the limitations period has passed. At other times, the statute simply bars the recovery. However, in tax law, it may be necessary to litigate the entire case before it can be ascertained which statute of limitations applied. Once it is determined, it may turn out that the statute was jurisdictional, thus, the court never had jurisdiction to hear the case, or it may bar the recovery.

This article discusses the unusual maze that must be navigated by a taxpayer desiring to file a claim for refund resulting from a change in a previously filed return. The scope is limited to an individual and an unusual specific set of facts. However, the general principles illustrate the problems that may be encountered by practitioners and taxpayers in this otherwise seemingly straightforward area.

II. GENERAL OVERVIEW OF STATUTES OF LIMITATION

Federal law as well as all state laws provides statutes which require that lawsuits be brought within a certain period of time. These statutes, limiting the period of time in which one can bring a lawsuit, are referred to as "statutes of limitations." Thus, a lawsuit may not be brought unless the suit is brought within a specified period of time after the right has accrued. These statutes balance the plaintiff's right to have a reasonable amount of time to prepare a case against fairness
to the defendant. Their purpose is to reduce the unfairness of defending actions after a substantial period of time has elapsed. Over time, memories fade and documents are lost and thus, a defendant will have greater difficulty defending a lawsuit when it is brought a long time after the event occurs. Further, the legal system seeks to avoid the anxiety and disruption caused by prolonged fear of litigation. The event which starts the running of the statute of limitations may vary. Sometimes this is the event itself that is the subject of the suit or prosecution (such as a crime or personal injury), but it may also be an event such as the discovery of a condition, such as discovering a defect in a manufactured good. In tax law, however, even the event may be hard to ascertain.

The fact that the statute of limitations has run does not necessarily mean that the court is deprived of jurisdiction to hear a matter,[3] and a plaintiff is not automatically barred from filing his or her claim because the statute of limitations has expired.[4] The court could not adjudicate the question of the proper application of the statute of limitations if it did not have subject matter jurisdiction.[5] This is especially critical in tax matters which may require an adjudication of the facts at issue before a determination as to which statute of limitations applies. However, the legislature may impose a provision for a time constraint that may be a subject matter jurisdictional requirement, if that is the apparent intent of the legislature.[6]

Statutes of limitation have aspects that are both procedural and substantive; procedural in that they regulate when a party may file a lawsuit and substantive in that they may affect the outcome.[7] Case law is mixed on whether the statute should be considered procedural or substantive.[8] However, the fact that a court has found that a time limit is procedural does not necessarily mean that the time limit is jurisdictional.[9]

While a statute of limitations generally is procedural[10] and extinguishes the remedy rather than the right, a statute of repose is substantive[11] and extinguishes both the remedy and the actual action.[12] Compliance with a statute of repose is a condition precedent to a party's right to maintain a lawsuit;[13] and when a time period is a condition precedent to a plaintiff's right to seek a remedy, the time period is jurisdictional.[14]

The determination of whether a statute is a conditional statute (barring the right to bring the action) or a statute of limitations (not barring the hearing but perhaps barring the recovery), turns on the statutory language used.[15] The language creating the statute must indicate clearly that a failure to comply with its terms bars the claim, and that filing by the prescribed time is a condition to the existence of the claim, or that failure to file deprives the court of jurisdiction.[16] The fact that the limitation is in
the statute that creates the cause of action is persuasive evidence that it is intended as a condition of the right created. However, this is not conclusive.\[17\] A time limitation is, generally, deemed a condition precedent if it is fixed in the statute, whereas a general time limitation must be pleaded as an affirmative defense if the cause of action comes about as a result of common law or by virtue of another statute.\[18\]

Because a statute of limitations must be pleaded as an affirmative defense, and is waived if it is not pleaded, a statute of limitation generally is not jurisdictional \[19\] unless it is a limitations period for claims against the government.\[20\] The federal statute that imposes a limitation on actions in the Court of Federal Claims\[21\] is jurisdictional.\[22\] However, the six-year statute of limitations for civil actions commenced against the United States\[23\] is not jurisdictional, given that the statute makes no mention of jurisdiction, but only creates a procedural bar.\[24\] The receipt of a notice of deficiency\[25\] and the bringing of an action in the tax court within 90 days is jurisdictional, as is the 12 month filing requirement under § 6411.\[26\]

Most jurisdictions provide that limitations are tolled under certain circumstances. Tolling will prevent the time for filing suit from running while the condition exists. In general, the law recognizes two types of special circumstances which would make the operation of the statute of limitations unfair. The first is where the plaintiff may be under a disability making it difficult for the plaintiff to bring an action within the required time period (e.g. the plaintiff may be too young, disabled, or imprisoned). In these circumstances, many statutes provide an additional period of time (e.g. one year after the plaintiff becomes an adult, is judged competent, or is released from prison). The second special circumstance is where the plaintiff is unaware of the cause of action and the operation of the statute without some exception would impose an unfair hardship. For example, some types of fraud may not be discovered for some time, defaults in title may not be discovered until the party tries to sell the property, or in medical malpractice cases an injury may not be discovered for years. In these situations, the time periods provided in the statute of limitations may begin to run when the injury is discovered, not when it happens.

Such is not the case in claim of right situations in taxation. Instead, a special code section provides a separate remedy with its own jurisdictional statute of limitations and leaves the general statute of limitations in place to run even though the event has not been discovered.

The length of the statutes of limitations varies from country to country and state to state even for the same types of actions. The length of the statutes of limitations are unique to tax law itself. The length of time often depends on the type of action or the seriousness of the act. For example, some crimes such as murder are
so horrific to society that they have no statute of limitations. Presumably, failure to file a tax return and filing a fraudulent tax return rise to the same horrific category, as they too have no statute of limitations.

In tax law, as in state and federal civil and criminal actions, the statute of limitations acts to provide a date of finality after which neither the IRS nor the taxpayer may bring a lawsuit in regard to a previously filed tax return or to a tax transaction. In most civil or criminal actions, the nature of the action is known in advance (e.g. a crime of murder, a contract action, fraud, etc.) Thus, the parties are aware of the date for computation of the statute of limitations. The only point of issue may arise in those causes of action that start the statute when the plaintiff becomes aware that the injury has occurred. In those situations, the parties may argue about exactly when the plaintiff became aware. However, unlike most other civil and criminal actions, the time of the statute of limitations for tax actions may depend upon the ultimate findings in the lawsuit relating to underlying tax issues (e.g. is the item income, was it undervalued, etc.) Thus, the parties may not even know which statute of limitations they are under until the lawsuit is finished. It is possible, therefore, for the parties to have completed the litigation, and only upon the finding of the facts, discover that the lawsuit was barred by the statute of limitations.

From the Government's perspective, statutes of limitation restrict the taxpayer's right to claim a refund of overpaid tax or initiate litigation to obtain a refund. From the taxpayer's perspective, statutes of limitation prevent the IRS from undertaking an audit, collecting a deficiency in tax or beginning a civil or criminal case.

III. THREE-YEAR STATUTE OF LIMITATIONS

Under I.R.C.§ 6501(a), the IRS must first assess the amount of tax before it can take action to collect it. Assessment occurs when an authorized IRS employee signs Form 23-C. The IRS cannot assess a tax after the statute of limitations on assessment has expired even if the taxpayer agrees to the assessment. Under IRC § 6501(a) and Reg. § 301.6501(a)-1(a), the IRS is required to assess tax within 3 years after the tax return was filed with the IRS.

The IRS has up to three years from the due date of a tax return, or the date of filing, whichever is later, to assess all income taxes due (“three-year rule”). A tax return filed prior to the due date is treated as if filed on the due date. The statute of limitation on assessment begins to run on the day after the taxpayer files the return. Thus, the day of filing is excluded from the computation of the three-year period. A timely mailed return is treated as filed on the due date of the return even if
it is received by the IRS after the due date. Amended returns do not extend the original 3-year period.

The three-year rule can be extended by agreement of the parties. Parties to an audit will frequently agree to an extension to keep the IRS from assessing in order to meet the statute of limitations. Any such agreement must be in writing and must be signed by the taxpayer and the IRS before the expiration of the original three-year rule.

The three-year rule may also be suspended after a timely issuance of a proper and valid notice of deficiency. This may occur upon the following:

A. Application by the taxpayer for a Taxpayer Assistance Order;
B. Filing of a Bankruptcy petition;
C. Application for a Receivership;
D. Issuance of a Summons by the IRS to a third-party;
E. Issuance of a designated summons by the IRS to a corporate taxpayer.

IV. RETURN PREPARED BY AN IRS OFFICIAL

A return prepared by an IRS official or employee in the situation of a taxpayer who has not filed a return will not start the statute of limitations. If an IRS agent or employee prepares a return for a taxpayer who did not file a return and assesses tax on that return and then later discovers that he prepared the return incorrectly, the IRS has no restrictions on the amount of time that they can come back and reassess additional tax. A taxpayer for whom a substitute return was prepared can, however, start the running of the three-year statute of limitations on assessment by filing a correct return.

1. ASSESSMENT OF PENALTIES

As a general rule, the IRS must assess tax, or file suit against the taxpayer to collect the tax, within three years after the return is filed. The three-year period of limitation on assessment also applies to penalties. Under IRC § 6665(a), additions to tax, additional amounts, and penalties (IRC §§ 6651-6724) are assessed and collected in the same manner as tax. Furthermore, any reference in the Code to "tax" includes such additions and penalties.
2. WHEN IS A RETURN "FILED"

The timely mailing of a return is treated as timely filing. Thus, even though the IRS receives the return after the due date, the return will be considered timely if it was mailed to the IRS by the due date. The date of the postmark stamped on the envelope by the U.S. Postal Service determines the date it was mailed. However, if the IRS does not receive it or loses it, the taxpayer must prove that it was sent. Hence the recommendation that all returns be filed by certified mail with a “return receipt requested”. If the return is sent by registered or certified mail, the registration mark provides prima facie evidence that the form or document in the envelope was actually delivered to the IRS. Tax information sent through a private delivery service such as Federal Express or UPS qualifies under the timely mailed/timely filed rule. A registration date or the date stamped on the sender's receipt is treated as the postmark date when sent by a private delivery service. The statute of limitations does not begin to run if the taxpayer files a return with the wrong Service Center.

3. WHAT CONSTITUTES A "RETURN"?

A person required to file a return must do so "according to the forms and regulations prescribed by the Secretary". The person must sign the return and the return must contain a written declaration made under penalty of perjury. The Supreme Court has identified the basic elements of a return that start the running of the statute of limitations on assessment. Those elements are:

A. the taxpayer must purport to file a return,
B. sworn to as such,
C. that shows an honest and genuine attempt to satisfy the law. It is not required that the return be perfectly accurate. The Internal Revenue Manual adds additional requirements: the taxpayer must provide sufficient information to enable the IRS to ascertain and assess the taxpayer's tax liability. This requires that 1) the amount of income be disclosed, and 2) that the nature of the income must be disclosed (e.g. earned income, passive income, investment income, etc.).

4. SIX-YEAR EXCEPTION TO THREE-YEAR RULE, IRC § 6501(E)

A six-year statute of limitations on assessment applies to returns that omit a substantial amount of gross income. The statute of limitations is extended to six years when the taxpayer omits gross income in an amount exceeding 25% of gross income actually reported on the income tax return. The extended statute gives the IRS extra time to identify and assess a deficiency in situations where the taxpayer’s return gives no clue as to the existence of the omitted income.
The limitations period is extended with respect to the taxpayer's entire tax return for the year, not just the specific omitted items of income. An item of income is not considered omitted from a return if the return or an attached schedule contains adequate information to apprise the District Director of the nature and amount of such item. Taxpayer’s must include enough information to allow the IRS to “audit” the return on its face. Adequate disclosure may include information from a combination of documents attached to the taxpayer's return, or in some cases, a combination of information from the return and information from another return such as a partnership or S corporation return in which the taxpayer is a partner or shareholder. The filing of a correct amended return does not shorten the six-year rule if the extended statute applied to the original return.

IRC § 6501(e) applies only to innocent or negligent omissions of gross income. Therefore, a six-year limitation period does not apply to fraudulent omissions of gross income, which instead can be assessed at any time.

V. NO STATUTE OF LIMITATION

There is no statute of limitations on the amount of time the IRS has to audit and assess additional tax if any of the following apply:

A. The taxpayer does not file a return;
B. A false or fraudulent return is filed with the intent to evade tax. The IRS has the burden of proving this for each year it assesses tax under the unlimited limitations period of IRC § 6501(c)(1);
C. The taxpayer attempts to defeat or evade any tax, other than income, estate, and gift tax.

The three-year rule does not apply to the assessment of taxes, interest and penalties attributable to a false or fraudulent return. In Badaracco, the Supreme Court held that the filing of a nonfraudulent amended return after filing a false or fraudulent return does not start the running of the statute of limitations on assessment. On the other hand, a correct return filed after a taxpayer has failed to file a return starts the running of the three-year statute of limitations on assessment.

1. STATUTE OF LIMITATIONS FOR COLLECTION OF TAX FROM TAXPAYER

The assessment of a tax imposes a lien on all of the taxpayer's tangible and intangible real and personal property. The IRS has ten years from the assessment
date to either collect the tax by administrative means (seizures, levies, offsets) or institute a suit for collection or a judgment.[63] If the IRS commences a timely suit to collect tax or to obtain a judgment, then it may continue its efforts to collect the tax even if it extends beyond the ten-year period.[64]

The following actions will act to extend the statute of limitations for collection:

A. The taxpayer signs a waiver of the statute of limitations. The 10-year IRS limitation can be extended by agreement provided the agreement is made prior to the expiration of the ten-year period.[65]

B. The taxpayer leaves the United States for more than six months, [66]

C. A bankruptcy by the taxpayer will extend the statute of limitations on nondischargeable taxes for the pendency of the bankruptcy plus six months (generally courts have held that the pendency of the bankruptcy is from the filing of a petition to date of discharge).[67]

2. LIMITATIONS ON TAXPAYER’S RIGHT TO CLAIM A REFUND

A taxpayer may file a claim for a refund of an overpayment of any tax within three years from the time the return was filed or two years from the time the tax was paid, whichever period is later. If no return was filed, the claim may be made within two years from the date that the tax was paid.[68]

A taxpayer may file a claim within seven years if the refund pertains to a bad debt under § 166 or § 832(c) or in connection with a loss from a worthless security under § 165(g).[69]

VI. CASE ANALYSIS

The rules relating to the statute of limitations seem to be at least navigable if not straightforward until you get into the actual application stage. Politicians, tax practitioners, and taxpayers all seem to agree with a remark by Albert Einstein, “The hardest thing in the world to understand is the income tax.”

Under the general rule, a taxpayer has a three-year statute of limitations in which to file an amended return. However, a taxpayer desiring to claim a tax refund from prior years may be required to wander through a maze of IRC sections, court cases, and IRS publications in order to ascertain if this is possible under the statute of limitations.
1. **FACTS:**

In early 1993, Taxpayer was forced to leave the workplace (a federal agency) allegedly due to misconduct on the part of her supervisor which caused and/or exacerbated a physical condition, resulted in psychological trauma, and rendered her totally disabled to perform work in her vocation. Thereafter, Taxpayer filed an internal complaint against her supervisor (as required by law before proceeding with further legal action). Taxpayer timely filed claims alleging sex discrimination, failure to accommodate a known disability, retaliation, and intentional infliction of mental distress under the Federal Tort Claims Act (FTCA).

Taxpayer’s Washington superiors instructed her to file for disability retirement under the Federal Employees Retirement System (FERS), which operates under the Federal Office of Personnel Management. Taxpayer eventually received taxable benefits under FERS equivalent to approximately 40 percent of the average of her three highest pay years.

Taxpayer’s superiors knew of her allegations regarding the supervisor’s misconduct (and the injuries resulting therefrom) during the time period for filing a claim for federal workers compensation benefits (a period which ended just a few months after Taxpayer left the workplace). However, no one at the federal agency advised Taxpayer of her right to file for federal Workers’ Compensation benefits with the U.S. Department of Labor, Office of Workers’ Compensation Programs (OWCP).

Shortly before the 1999 trial of Taxpayer’s various causes of action, the judge ordered Taxpayer to file with OWCP to determine whether or not she had a valid claim for benefits. A finding by OWCP that Taxpayer’s injuries were work related, and thus compensable, would bar her FTCA cause of action. Thus, the FTCA portion of the case was severed and the remaining claims went to trial.

In May of 2000, OWCP determined that Taxpayer had suffered injuries in the workplace and was eligible for benefits (which would retroactively begin for 1993 and continue throughout the disability). Taxpayer was eligible for benefits even though her OWCP claim was filed approximately seven years beyond the regulatory deadline. Taxpayer had submitted evidence to OWCP that verified that not only had her employer been aware of her allegations of workplace injuries during the original 1993 OWCP filing period but that she had also been directed specifically to file for FERS benefits without OWCP. OWCP benefits provide 75 percent of the injured worker’s pay if claimant has dependents and 66 percent if no dependents, and in addition, cover all medical costs related to the workplace injuries.
OWCP calculated back and front pay. As part of this process, OWCP was required to reimburse FERS for the benefits they provided Taxpayer from 1993 through the present and were required to pay Taxpayer the difference in the retroactive benefit differential. In addition, OWCP reimbursed her for medical expenses previously paid and deducted.

2. THE GENERAL ISSUE

At first glance, Taxpayer’s situation appears to be fairly simple. She reported and paid taxes on an amount which she received and to which she thought she had a right. Later it was determined that she had to repay the previously reported income and, in lieu thereof, received a greater amount of non-taxable income. In principle, it would seem that all she had to do was file amended returns reducing her taxable income by the amounts to which she was not entitled (and consequently had to repay) and claim refunds of taxes paid which did not have to be paid. It would seem that fairness would dictate the above simple remedy.

3. TAX ISSUES RELATED TO THE FACTS

Obviously, the facts suggest both legal and income tax issues. The legal issues raised and resolved in court will not be discussed. The tax issues presented are:

1. In general, may Taxpayer get a refund for prior years taxes which were based upon taxable retirement income, which were later reclassified as Workers’ Compensation?
2. When, and upon what basis, may she file for a refund? That is, can she file on the basis of a letter of determination from the Office of Workers’ Compensation Programs (OWCP), or must she wait until the actual receipt of money from OWCP, net of the amount repaid to the Federal Employees Retirement System (FERS)?
3. When she does file, must (can) she amends each prior return filed or can she do it in a lump-sum (with supporting calculations)?
4. Are (or will) her Workers’ Compensation payments really be non-taxable?
5. May she claim a deduction for the amount OWCP reimburses to FERS in her behalf?
6. Does she qualify for the net operating loss provisions?
7. How does she handle the reimbursement for medical expenses paid that she previously deducted as itemized deductions?
8. Are some prior years closed to her as to refund claims?
9. Does the fact that the delay in properly classifying the payments as Workers’ Compensation was caused by a federal agency affect Taxpayer’s filing status or statute of limitations?

10. Is there a best choice among various options under which she may choose to file?

4. REFUNDS IN GENERAL

IRC § 6402(a) grants authority to the Secretary to make refunds, or payments of any tax within the applicable period of limitations after netting the refund against any liability owed by the taxpayer for any internal revenue taxes. Paragraphs (b) and (c) expand the netting to allow credits against estimated taxes and past-due support payments owed because of the Social Security Act (§ 464). I.R.C. § 6402 (a) clarifies the term “overpayment” as being “… the amount of the payment of any internal revenue tax which is assessed or collected after the expiration of the period of limitation properly applicable thereto.”

While the above code section allows the possibility of a refund to a taxpayer, there are several obstacles and hurdles which one faces in order to actually get a check in the mail. I.R.C. § 6402(a) does not give the taxpayer blanket permission to file refund claims for all past overpayments, in that it specifically states that the Secretary’s authority to grant refunds is subject to, “… the applicable period of limitations.” The restriction allows a variety of limitation periods.

The general rule which governs the years for which refund claims may be filed is found in I.R.C. § 6511(a), which states:

Claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later.

Furthermore I.R.C. § 6511(b) reinforces paragraph (a) by stating, “No. . . refund shall be allowed or made after the expiration of the period of limitation prescribed in subsection (a). . .” As absolute as the rule appears, one may be justified in following the adage, “There’s an exception to every rule.” Several of the exceptions to the absolute rule are found in I.R.C. § 6511(c) and (d). Subsection (d)(2) concerning net operating losses, may apply to Taxpayer. Another major exception to the 3-year rule can be found in § 1314(d) which allows adjustments and refunds back to 1932. While it seems that Taxpayer can in general file refund claims
only for the prior three years, it is also possible that various exceptions to the general rule may allow her to go back to earlier years. Several court cases relating to the issue of extending the open years will be discussed later.

5. TAXABILITY OF WORKERS’ COMPENSATION

Taxpayer received the Worker’s Compensation money, spent it, and designated it as disability income. Disability income is taxable under §104. The income did not result from personal injuries or sickness from active service in the armed forces covered by §104(a)(4) and so could not be excluded under that section. She could have claimed that notwithstanding her non-military employment she was entitled to exclude the disability payments because §104(a)(2) excludes from gross income damages received on account of personal injury or sickness. The 1996 revision of the section restricted the exclusion to apply only to, “personal physical injuries or physical sickness”.

In Taxpayer’s case her employer caused her to suffer emotional injury. At issue then is whether the physical and emotional sickness qualifies her income to be excluded under §104(a)(2). The House Ways and Means Committee provided the following guidance on the matter: “If any action has its origin in a physical injury or sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury . . .”

However, the statute specifies that “emotional distress” is not a physical injury. Additionally, the 1996 amendments bar the exclusion for damages based on claims of employment discrimination or injury to reputation, even if the suit includes “a claim of emotional distress”. However, §104(a)(1) clearly states that “. . . gross income does not include. . . amounts received under Workers’ Compensation acts as compensation for personal injuries or sickness;” “personal injuries” under Workers’ Compensation is broad enough to include emotional distress. Thus, the physical injury or sickness criteria under § 104(a)(2) is not applicable. Since Taxpayer’s Workers’ Compensation falls clearly under § 104(a)(1) as compensation for personal injuries she is entitled to exclude all “reclassification” payments since they are amounts received as compensation under Workers’ Compensation. Future Workers’ Compensation payments will also be excludable.

6. DEDUCTIBILITY OF REIMBURSEMENT TO FERS

At first glance, the general three-year statute of limitations should bar Taxpayer from filing amended returns for pre-1999 years. However, at the time of the receipts, the amounts were not categorized under Workers’ Compensation. Only after
the trial were the amounts ordered changed to Workers’ Compensation and the retirement benefits reimbursed. Therefore, what is the statute of limitations for amounts which are recharacterized after the initial statute of limitations has run? Is it possible for her to file amended returns for refunds for the years prior to 1999 even though the retirement payments were received and included in those years? That is, at the time, the receipts were properly characterized as taxable retirement benefits and not as excludible benefits under a Workers’ Compensation act. Presumably, the retroactive payment for Workers’ Compensation which were received in full in 2002 could be excluded. However, in 2002 she also received some disability retirement pay reimbursements for medical expenses and in the same year had to re-pay all prior disability pay. Thus, without a tax refund, her Workers’ Compensation will have been subject to tax.

In general, the doctrine of equitable recoupment allows taxpayers to recoup overpayments, and the IRS to recoup deficiencies, that have been barred by the statute of limitations. However, the doctrine applies only to narrowly defined situations which require the offset of overpayments and deficiencies, or vice versa. In addition, the time-barred offset must, “arise out of the same transaction, term or taxable event as the overpayment or deficiency”.[71]

7. DEIMBURSEMENT OF PRIOR DEDUCTION

Another set of provisions which may reduce Taxpayer’s refund claim stems from the “tax benefit rule”. This rule is found in I.R.C.§ 111. An excellent history of the law behind Section 111 may be found in Bittker and Lokken’s Federal Taxation of Income, Estates, and Gifts, Second/Third Edition. As Bittker and Lokken explain, the principle was first developed by the courts and narrowly applied, but later (1984) incorporated by statute in a broad manner.

The tax benefit rules of I.R.C. § 111 generally state that if a deduction taken by a taxpayer which reduced the taxable income in year one is recovered in a later year (e.g. year two) then the amount of the recovery shall be included as income in year two. The tax benefit rule evidently maintains the purity of tax years as to what actually happened and reduces the administrative burden which would be created by amended returns, refunds and/or interest payments. The rule is applicable to Taxpayer since during the years in question, she took deductions for medical and legal expenses some of which were reimbursed to her from OWCP.

Taxpayer’s tax benefit from the reimbursement of medical expenses is limited because at the time the deductions were taken, they were limited to the excess of the medical expenses over 7.5% of her adjusted gross income (AGI). For example, if
AGI were $40,000 and total medical expenses were $3,500, she was only able to
deduct $500 ($3,500 - 3,000(0.075 x 40,000)). So, while she was reimbursed $3,500,
only $500 produced a tax benefit within the tax benefit rule and must be reported as
income. When the tax benefit rule is applied to an individual who did not deduct
medical expense as an itemized deduction, none of the recovery is income. Or, in the
event that the allowed medical deduction created total itemized deductions that exceed
the standard deduction by $800, then only $800 would be subject to taxation.

The fact that some unfairness may result due to the recovery year placing the
taxpayer in a higher marginal tax rate than the rate when the deduction took place is of
no consequence. The IRS looks at dollars as “taxed dollars or previously taxed
dollars”. Thus, all dollars are the same regardless of the rate of tax imposed. As
Bittker and Lokkin explain:

. . . (T)he courts have been satisfied with the rough-and-ready adjustment that
results from taxing the recovery at whatever rate prevails in the year of
recovery, and have not insisted on exacting a tax equal to the amount saved by
the taxpayer in the earlier year.\[72\]

In Taxpayer’s case the above works in her favor, in that in the recovery year
she paid no tax due to the I.R.C. § 1341 provisions. However, one must be careful in
computing the includable recovery due to changes in the percentage of non-deductible
medical expenses resulting from changes in the percent of AGI factor. The specific
instructions for tax benefit receipts are found in IRS Publication 525.

8. EXTENDING THE REFUND YEARS

I.R.C. §§ 1311-14 deal with correction of errors which have occurred since
1932.\[23\] Are the rules applicable to Taxpayer? The general rule of the sections states
that if the correction is, “. . . prevented by the operation of any law. . . other than this
part. . . then the effect of the error shall be corrected by . . . section 1314.” As shown
earlier, this deals only with specific situations, none of which apply to Taxpayer.

9. CLAIMS FOR REFUND AFTER THE STATUTE OF LIMITATIONS HAS
RUN

I.R.C. § 6511(a)(1) clearly states that a claim for credit or refund of an
overpayment shall be filed by the taxpayer within 3 years from the time the return was
filed or 2 years from the time the tax was paid. The Supreme Court in the 1996 case
of United States v. Mariann Brockamp \[74\] reversed the Ninth Circuit and stated that
the limitations set forth in I.R.C. § 6511 cannot be tolled for non-statutory equitable
reasons. The court said, “Section 6511 sets forth its time limitations in a highly detailed technical manner, reiterates them several times in different ways, imposes substantive limitations, and sets forth explicit exceptions to its basic time limits that do not include ‘equitable tolling’… There are no counterindications of congressional intent.”

Revenue Rule 78-161 arose from the 1976, 4th Circuit case of Strickland v. Commissioner[75]. In this case, the taxpayer retired from the U.S. Army and received retirement pay based on years of service. Later, the Veterans’ Administration awarded disability pay retroactively. The years of service pay was reduced by the disability pay. The prior rule on such awards, Revenue Ruling 62-14, was revoked by Revenue Ruling 78-161 which ruled, “the Internal Revenues Service will follow the decision of the United States Court of Appeals for the Fourth Circuit in Strickland as precedent in the disposition of similar cases involving section 104(a)(4) of the Code.”

While Strickland allows retroactive adjustments of tax due to reclassification of taxable retirement income to non-taxable disability income, it applies only to I.R.C. § 104(a)(4) disability pay connected with active duty in the armed forces. It also requires that the refund be sought within the limitations period.

Moreover, Revenue Rule 78-161 was discussed in the Sullivan case (discussed below). The Court noted that, “veterans may rely upon a retroactive award of the VA, for an adjustment in their tax liability.” The Strickland case, however, does not reach or address the question of how far back such adjustments may be made or how to adjust taxable income in the case of an expired statute of limitations under 26 U.S.C.A. § 6511.

Thus, Taxpayer can get no help from Revenue Ruling 78-161 because her federal employment was not with the military and moreover it gives no guidance as to the mechanics of filing her refund claim and fails to provide an exception to the three-year statute of limitations for filing a refund claim. She must look elsewhere for a remedy.

Two relevant court cases which do apply to Taxpayer are Joosten and Sullivan. The case of Joosten v. United States[76] is relevant to Taxpayer for several reasons. Briefly, the facts are as follows: Plaintiff’s husband, a veteran, died in 1982 and soon thereafter she began receiving survivor benefits from the Army Finance Center (AFC). These benefits continued until 1991 and Plaintiff filed timely tax returns and claimed the benefits as income. In July 1991, the Veteran’s Administration determined that the husband had in fact been entitled to Disability
Indemnity Compensation (DIC) under the Agent Orange Act of 1991. Consequently, the VA reimbursed the AFC for the survivor benefits and paid the Plaintiff DIC benefits which are not taxable. In May of 1993, Plaintiff filed a refund claim for taxes paid on the AFC payments from 1989-1991. The IRS refunded the taxes with interest. In 1994, Plaintiff again filed for a refund for the taxes paid on the AFC benefits for the years 1983-1988. The later refund claim was the issue before the New Jersey District Court.

As to the closed years (1992-1997) being re-opened, the Joosten court rejected the request, based upon the Supreme Court’s reasoning from Dalm, 494 U.S. at 602 “. . . the import of these sections [7422 and 6511] is clear: unless a claim for refund of a tax has been filed within the time limits imposed by sec. 6511 (a), a suit for refund, regardless of whether the tax is alleged to have been ‘erroneously’, ‘illegally’, or ‘wrongfully collected’ (sec. 1346 (a) (1), 7422 (a), may not be maintained in any court.”[72]

After consideration of the statutory framework governing refund claims, in particular the interplay between I.R.C. §§ 6511(a) and 7422, the Supreme Court held that:

tax refund claims may not be premised on an equitable theory in defiance of the statutory bars to recovery. Id. at 601-02. Indeed, the failure to file a timely claim is unequivocally described as an absolute bar:[T]he import of these sections is clear: unless a claim for refund of a tax has been filed within the time limits imposed by §6511(a) , a suit for refund, regardless of whether the tax is alleged to have been "erroneously," "illegally," or "wrongfully collected," §§1346(a)(1), 7422(a) , may not be maintained in any court. [78]

Thus, Dalm represents the Supreme Court's rejection of equitable modification of the filing limits on refund claim statutes set by I.R.C. § 6511(a).

The Joosten Court further stated, “Plaintiff attempts to circumvent the bar of the statute of limitations set forth in Section 6511 (a) by arguing that she is entitled to equitable relief. The use of equitable principles to mitigate a taxpayer’s failure to submit a timely refund claim was explicitly considered and rejected by the Supreme Court in Dalm.” The court continued, “The Third Circuit, in the Kreiger decision, recognized the importance of the government’s interest in the efficient collection . . . noting that equitable tolling of the tax refund limitations would be an otherwise unreasonable burden upon orderly administrative function.”[79]
The reasoning and conclusions are clear. The three-year limit for refunds imposed by §6511 is cast in concrete. Taxpayer may not open closed years. The interesting fact of the case that concerns Taxpayer concerns the first refund claim made and paid by the IRS. The question is, why did Mrs. Joosten get a refund for the open years of 1989-1991? Was not her situation one that falls under IRC §1341 Claim of Right? On what basis could she claim the refund when it was evidently based solely on a re-classification of prior taxable income (AFC) to non-taxable (DIC) benefits after the AFC payments had been reimbursed by the DIC? Because Taxpayer so closely parallels the facts of Joosten, may she not also file for a refund, plus interest, for the taxes paid on disability retirement income after it was reclassified as tax exempt Workers’ Compensation? The relevance of the Joosten case only covers Taxpayer’s open years because the court ruled that the closed years (beyond the § 6511 three-year limitation) may not be re-opened. Joosten dealt only with the closed year issue and the details of the first refund are only mentioned and specifics not discussed.

The case of John G. and Collen A. Sullivan[80] is similar in some respects to Joosten, previously discussed. In Sullivan, the taxpayers had numerous adjustments to Mr. Sullivan’s military disability rating and used the higher rating to file their returns and thereby reduce taxes. Their returns were based upon Rev. Rul. 78-161. The novel aspect of their case was that Plaintiffs argued that their claim did not constitute a claim for overpaid taxes but a categorization as, a “recommendation for monetary benefit.” (p.1) Thus they took their case to the U.S. Court of Federal Claims. The facts state that the IRS allowed a refund (plus interest) of $18,660.20 for the years 1993-1995 and disallowed in total claims for 1988-1992. In part the IRS said, “Revenue Ruling 78-161 applies to only those years not closed by the statutes of limitations.”

The bulk of the case dealt with the issue of whether or not the Court of Federal Claims had jurisdiction and, if so, could it waive the § 6511(a) limitations. The doctrine of equitable estoppel was discussed in detail and U.S. v. Brockamp was quoted as follows, “Congress did not intend the ‘equitable tolling’ doctrine to apply to section 6511's time limitations. . . . In addition, Sec 6511 sets forth explicit exceptions to its basic time limits, and those very specific exceptions do not include equitable tolling.”[81]

The court went on to observe that, “The nature and potential magnitude of the administrative problem suggests that congress decided to pay the price of occasional unfairness in individual cases (penalizing a taxpayer whose claim is unavoidably delayed in order to maintain a more workable tax enforcement system.”[82]
As to Strickland the court noted that the case stood for the “... general proposition that disability awards are not taxable as gross income and that, in appropriate circumstances, veterans may rely upon a retroactive award of the VA, for an adjustment in their tax liability.” The Strickland case, however, does not reach or address the question of “how far back such adjustments may be made or how to adjust taxable income in the case of an expired statute of limitations under 26 U.S.C.A. sec. 6511.”[83]

The Joosten court emphasized that, “unlike the federal statutes that have been found subject to equitable tolling, the tax laws do not have a broad remedial purpose, nor are they drafted to be especially protective of plaintiffs. To the contrary, the tax laws are designed to accomplish the efficient and even-handed collection of revenue from over 200 million taxpayers. . .”[84]

While the referenced cases of Joosten, Strickland and Sullivan (dealing with military disability situations) are dissimilar to Taxpayer’s, they are relevant to her case in several respects. The cases re-affirm that Taxpayer cannot amend or in any way adjust the taxes for years barred by § 6511(a). On a positive note Joosten and Sullivan were both allowed to amend returns for the years still open by § 6511(a) even though their refund claims involved nothing more than having the prior year’s income re-classified as non-taxable income.

10. RELIEF UNDER §§ 1341 AND 6411

Fortunately, Taxpayer is not required to claim a refund under I.R.C. § 6511 and in fact the three-year statute would prevent her from doing so. I.R.C. § 6411, provides that Taxpayer may file a “Tentative claim for Refund” which is not actually a claim for refund, within twelve months of having to payback amounts previously included under a claim of right. Since this is a “Tentative claim” and gives the Taxpayer no rights to appeal or to the courts, there is no reason for the statute of limitations to apply. It simply provides an opportunity for Taxpayer to calculate the tax in the current year by calculating the tax in the previous years and provides for a reduction of tax for the reduction that would have occurred in the previous year or in the alternative, Taxpayer may simply take a deduction in the current year for the amounts repaid. However, nothing in the process allows for an extension of the statute of limitations.

In short, fairness would seem to be in Taxpayer’s favor regarding the filing of a claim for refund under the traditional amended return, request for refund, and appeals process, however congress has said otherwise and has provided an alternative. Note, however, that whether or not to grant the refund under the
“Tentative Request” of I.R.C. § 6411 is completely under the discretion of the IRS with no appeals procedure available to the Taxpayer. As the court noted in Brockamp, “Tax law, after all is not normally characterized by case-specific exceptions reflecting individualized equities.”\[85\] Only a § 6411 claim can attempt to give Taxpayer some relief for the taxes paid in the closed years.

11. CLAIM OF RIGHT

In order for Taxpayer to be subject to the relief provisions, she must demonstrate that her situation falls under the provisions of I.R.C. § 1341, which deals with the claim of right doctrine. § 1341 provides as follows:

Sec. 1341 COMPUTATION OF TAX WHERE TAXPAYER RESTORES SUBSTANTIAL AMOUNT HELD UNDER CLAIM OF RIGHT

1341(a) Sec. 1341 [1986 Code]. GENERAL RULE.--If--

1341(a)(1) an item was included in gross income for a prior taxable year (or years) because it appeared that the taxpayer had an unrestricted right to such item;

1341(a)(2) a deduction is allowable for the taxable year because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item or to a portion of such item; and

1341(a)(3) the amount of such deduction exceeds $3,000, then the tax imposed by this chapter for the taxable year shall be the lesser of the following:

1341(a)(4) the tax for the taxable year computed with such deduction; or

1341(a)(5) an amount equal to--

1341(a)(5)(A) the tax for the taxable year computed without such deduction, minus

1341(a)(5)(B) the decrease in tax under this chapter (or the corresponding provisions of prior revenue laws) for the prior taxable year (or years) which would result solely from the exclusion of such item (or portion thereof) from gross income for such prior taxable year (or years).

Taxpayer included the retirement income as taxable income because it appeared at the time that she had an unrestricted right to the income. It was only in later years that it was established that the income should have been Workers’ Compensation income and that the retirement income had to be repaid. This clearly falls under the provision of § 1341 and is supported by the above-mentioned case law. Under the case law, Taxpayer would be allowed to file claims for refund under § 6511 for only the years that were still open but would be barred for claiming a refund for closed years.
I.R.C. § 6411(d)(1) provides a form of modification of the general statutes of limitations in order to apply the provisions of § 1341. Reg. § 5.6411-1 provides that a taxpayer may file for a tentative refund which is not a claim for refund or credit. Since it is not a claim for refund or credit it does not come under the general statute of limitations. The regulation provides as follows:

Reg. § 5.6411-1 Tentative refund under claim of right adjustment (Temporary).

(b) In general. Section 6411(d) allows taxpayers to apply for a tentative refund of amounts treated under section 1341(b)(1) as an overpayment of tax under a claim of right adjustment. . .

(2) Computation under section 1341(a)(4). The application must contain the following information related to the computation under section 1341(a)(4):

(i) The amount of income restored by the taxpayer to another during the taxable year and the amount of the corresponding deduction described in section 1341(a)(2);
(ii) The tax for the taxable year computed with the deduction described in section 1341(a)(2); and
(iii) The tax for each prior taxable year (determined before adjustment under section 1341) to which any net operating loss described in section 1341(b)(4)(A) may be carried and the decrease in tax for each of those years that results from the carryback of that loss.

(3) Computation under section 1341(a)(5). The application must contain the following information related to the computation under section 1341(a)(5):

(i) The tax for the taxable year without the deduction described in section 1341(a)(2);
(ii) The tax for each prior taxable year (determined before adjustment under section 1341) for which a decrease in tax is computed under section 1341(a)(5)(B);
(iii) The decrease in tax for each prior taxable year computed under section 1341(a)(5)(B), including any decrease resulting from a net operating loss or capital loss described in section 1341(b)(4)(B); and
(iv) The amount treated as an overpayment of tax under section 1341(b)(1).

(e) Time and place for filing. The application must be filed no earlier than the date of filing the return for the taxable year of restoration and no later than the date 12 months from the last day of that taxable year. . .

(f) Not a claim for credit or refund. An application for tentative refund under section 6411(d) is not a claim for credit or refund. The principles of paragraph (b)(2) of § 1.6411-1 apply in determining the effect of an application for a tentative refund. For example, the filing of an application for tentative refund
under section 6411(d) is not a claim for credit or refund in determining whether a claim for credit or refund was timely filed.

Payments received under a claim of right are correctly includable in income in the year they are received even though it may be discovered in a later year that they must be repaid. Thus, the inclusion of the FERS payments was correct. However, the Taxpayer is allowed to deduct the repayments of the FERS amounts paid in the year in which they are repaid. Taxpayer may take a deduction for the amounts paid in the year paid. However, taking a deduction in a year in which all the income is found to be non-taxable does not adequately compensate the Taxpayer for the tax paid in the earlier years.

I.R.C. § 1341 alleviates the inequity caused by the timing differences if the amount repaid exceeds $3,000. Taxpayer’s repayment exceeded $3,000. In this case, Taxpayer may reduce her tax in the year of the repayment by the amount of tax paid in the previous years that was attributable to the inclusion of the repaid amount. This necessitates a recalculation of the tax for the prior years but does not require the filing of an amended return. Instead the reduction in the tax is treated as a deduction. Any excess should be claimed as a refund. However, if a smaller tax liability results from simply deducting the repaid amount in the year of repayment, the taxpayer should claim the deduction instead.

Regardless of whether the Taxpayer chooses to reduce her tax or claim a deduction, the adjustment is made for the year of repayment. The returns for the prior years in which the FERS payments were included are not reopened.

The amount of the repayment cannot be taken into account for any purpose other than the computation. Thus, prior years itemized deductions or net operating losses are not affected. For example, the repayment generally cannot be used to change a net operating loss. In determining whether tax for the year of repayment should be computed (1) with a deduction for the tax year or (2) without such deduction but taking into account the decrease in tax for prior years that results from excluding the amounts from income, net losses for the tax year are preserved and net operating losses and capital losses for prior years are also preserved.

“A taxpayer may file an application for a tentative refund of any amount treated as an overpayment of tax for the taxable year under I.R.C. §1341(b)(1)”, provided that the application shall, “... be filed during the period beginning on the date of filing the return for such taxable year and ending on the date 12 months from the last day of such taxable year. . .”
Reg. § 1.1341(a)(2) explains the meaning of a claim of right as “an item included in gross income because it appeared from all the facts available in the year of inclusion that the taxpayer had an unrestricted right to such item”, and “restoration to another” means a restoration resulting because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item. . .”

This section appears to give Taxpayer some relief in that she had to repay the retirement pay. Thus, she can claim a deduction for the year in which she pays back the disability retirement income to FERS.

12. NET OPERATING LOSS

The next issue is whether or not Taxpayer’s 2002 deduction can create a net operating loss which can be carried back to some earlier years. Reg. § 1-1341-1(b)(1)(iii) states, “. . . if the deduction of the amount of the restoration results in a net operating loss for the taxable year of restoration. . . [it] shall be carried back. . . as is provided under section 172. . .” In order to determine the applicability of the law to Taxpayer’s case it is necessary to see how (and where) the deduction is taken and then to examine the rules of NOLs. The rules governing net operating losses (NOLs) are found in I.R.C. § 172. A net operating loss is defined in § 172(c) as “an excess of the deductions allowed by this chapter over gross income.”

The NOL provisions provide that a loss can only be carried back two years to reduce the income of the year and perhaps create a refund for those years. However, an NOL can be carried forward 20 years to reduce future taxes. The kicker in the NOL provisions is that the allowable deductions in general pertain only to trade or business activity and not personal deductions. I.R.C. § 172(d)(3) states, “No deductions shall be allowed under I.R.C. §151 (relating to personal exemptions)” I.R.C. § 172(d)(4) explains that: “In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which is not attributable to a taxpayer’s trade or business shall be allowed only to the extent of the amount of income not derived from such trade or business.” Income from salary or personal services, however, is income considered business income and can be offset by an NOL.

In addition, any deduction for casualty or theft allowable under paragraph (2) or (3) of I.R.C. § 165 (c) is treated as attributable to a trade or business. It may also be noted that an individual may also deduct an allowable “moving expense” in computing an NOL. In short, non-trade or business deductions can be netted
against non-trade or business income but only to zero-out the latter, but no loss may result. However, Reg. § 1.172-3 explains

(3) Nonbusiness deductions—(i) Ordinary deductions. Ordinary nonbusiness deductions shall be taken into account without regard to the amount of business deductions and shall be allowed in full to the extent, but not in excess, of that amount which is the sum of the ordinary nonbusiness gross income and the excess of nonbusiness capital gains over nonbusiness capital losses. See paragraph (c) of this section. For purposes of section 172, nonbusiness deductions and income are those deductions and that income which are not attributable to, or derived from, a taxpayer's trade or business. Wages and salary constitute income attributable to the taxpayer's trade or business for such purposes. 

Taxpayer’s I.R.C. § 1341 claim of right deductions may create an NOL for 2002 but she may not have any income against which the NOL may be used.

13. FILING OPTIONS

After getting her check from OWCP (which includes the retroactive adjustment, the reimbursement for medical expenses, and the pay-back to FERS) Taxpayer may file amended returns (form 1040X) for the open years. The 1040X, of course, requires documentation of the facts and a letter of explanation for the amendment.

1. Method of Applying for Tentative Refund under § 6411(d) Applying § 1341.

For tax years that are not still open, § 1341 provides alternative methods of relief. In this case, Taxpayer may, simply, reduce the taxable income by the amount of the repayment. In the alternative Taxpayer may reduce her tax in the year of the repayment by the amount of tax paid in the previous years that was attributable to the inclusion of the repaid amount. This necessitates a recalculation of the tax for the prior years but does not require the filing of an amended return. Instead the reduction in the tax is treated as a credit on the return for the current year. Any excess should be claimed as a refund. However, if a smaller tax liability results from simply deducting the repaid amount in the year of repayment, the taxpayer should claim the deduction instead.

If the Taxpayer chooses not to file an amended return for the open years and, in any event, wishes to apply for the Tentative Refund, (for the years no longer open) the application is made by filing Form 1045 (the NOL Carryback form). The
application must be made by filing those forms even if the taxpayer is not applying for a tentative carryback adjustment under § 6411(a). Taxpayer must attach to the form a separate schedule containing the information required under § 6411(d).

For the year 2002 Taxpayer’s return should either show a large miscellaneous itemized deduction not subject to the 2% of AGI floor. (Schedule A, line 27) for her claim of right reimbursed to FERS or should include form 1045 with the recalculation of the previous taxes paid attributable to the repayment. The 2002 return will also include tax-benefit income for medical expenses taken in 1993-1998 and 2002; for which she was reimbursed.

The best option for Taxpayer is to file Form 1045. The instructions for Form 1045 state that, “Individuals may get a refund by filing Form 1040X, amended U.S. Individual Income Tax Return, instead of Form 1045.” However, the same instructions state that the purpose of Form 1045 is to allow individuals to apply for a quick refund resulting from, “an overpayment of tax due to a claim of right adjustment under Section 1341(b)(1).” Further, the instructions clarify that, “The IRS is not required to process your Form 1040X within 90 days.” Thus, in order to get the quick refund Taxpayer should file Form 1045. Moreover she “. . . must file Form 1045 within 1 year after the end of the year in which the . . . claim of right adjustment arose.” The claim of right adjustment amount is to be entered on line 29 (year 2002 Form 1045) and is to be supported by the information required by the following information:

a. Taxpayer’s name, address, and identification number;
b. The amount of income restored by the taxpayer to another (FERS);
c. The amount of the deduction taken under Section 1341(a)(2) on Schedule A, Form 1040;
d. The tax for the year competed with the deduction taken;
e. The tax for each prior year determined before the Section 1344 adjustment and the decrease in tax that results; and
f. The amount treated as an overpayment of tax under Section 1341(b)(1).

The regulations also muddy the water by stating, “An application for a tentative refund under § 6411(d) is not a claim for credit or refund.” However, the regulations go on to say, “. . . the filing of an application for tentative refund under § 6411(d) is not a claim for credit or refund in determining whether a claim for credit or refund was timely filed. § 6411(d)(1) merely says, a taxpayer may file an application for a tentative refund of any amount treated as an overpayment of tax for the taxable year under §1341(b)(1)” . Thus, presumably, taxpayer could file amended returns for
the open years or under § 6411 file a tentative refund under the claim of right doctrine presumably for all years effected.

V. SUMMARY

The maze of finding the solution required that we journey through the 1986 IRS Code Sections relating to: granting the secretary the right to make refunds; time limits for refund claims; claim of right doctrine; includable/excludable receipts for personal injury and disability income; net operating losses; cash basis accounting; exceptions to limitation for correcting prior years’ returns; tax benefit rule: and recovery of prior year deductions.

Statutes of limitations are supposed to reduce the unfairness of defending actions after a substantial period of time has elapsed and avoid the anxiety and disruption caused by a prolonged fear of litigation. Unfortunately, in the area of taxation, it is the substantive tax issues that determine which statute of limitations will apply. In those situations, the statute cannot be determined until the underlying issues have been resolved which ultimately determine which statute should have been applied in the first place. Thus, the whole purpose of statutes of limitations has been modified to be a statute that does not determine whether the lawsuit can be brought or not, but must play another role once all the substantive issues have been resolved which determine which statute should have been applied in the first place to bar the action or reduce its remedies. In some instances, such as in the § 1341 claim of right provision, the whole notion of a statute of limitations has been superseded by a remedy that allows a taxpayer to go back an unlimited number of years and compute the tax savings, but then requires this cumulative adjustment to be currently reported on the tax return, thus, presumably not changing the statute of limitation but simply circumventing it.

Our Taxpayer had an unusual, but not totally unique, situation which justified her filing for refunds of previously paid taxes. Whereas the laymen’s sense of fairness would suggest that she should be able to correct all prior years found to be in error, the tax laws require a much more complex and confusing solution.

REFERENCES


[26]. I.R.C. § 7442.


[29]. IRC § 7502.


[31]. IRC § 6501(c)(4).

[32]. IRC § 6503(a)(1).

[33]. IRC § 7811(d).

[34]. IRC § 6503(h).

[35]. IRC §§ 6036 and 6872.

[36]. IRC §§ 7609(a), 7609(e)(1), and 7609(f).

[37]. IRC § 6501(k).
If the tax return was prepared by the IRS under the authority of § 6020(b) the statute of limitations does not apply. See § 6501(b)(3) and Reg.§ 301.6501(b)-1(c).

IRC § 6501(a); Reg.§ 301.6501(a)-1(a).

IRC § 7502(a).

IRC § 7502.

IRC §§ 7502(c) and (f).


IRC § 6011(a).

IRC § 6061.


Zellerbach Paper Co. v. Helvering, 293 U.S. 172, 35-1 USTC 9003, 14 AFTR 688 (1934).

IRM 4231, § (11)34.

IRC § 6501(e).


Stephen Colestock, 102 TC No. 12 (1994).

Reg.§ 301.6501(e)-1(a)(1)(ii).

Rev. Rul. 55-415; Berderoff v. Commissioner, 398 F.2d 132 (8th Cir. 1968).


IRC § 6501(c).

IRC § 6501(c)(3).

IRC § 6501(c)(1).

[59] IRC § 6501(c)(2).


[63] IRC §6502(a).

[64] IRC § 6502(a).

[65] IRC § 6501(c)(4); Reg. §301.6501(c)-1(d).

[66] IRC § 6503(c).

[67] IRC § 6503(b).

[68] IRC § 6511(a).

[69] IRC § 6511(d)(1).


[73] I.R.C. § 1314(d).


[77] *L.E. Joosten*, DC N.J. (unpublished opinion), 96-2 USTC ¶50,393 p.3.

[78] U.S. v Dalm, 110 SCt 1361, 494 US 596, 602 revg CA-6, 867 F.2d 305.

[79] Kreiger, 539 F. 2d 322.


[84]. L.E. Joosten, DC N.J. (unpublished opinion), 96-2 USTC ¶50,393.


[86]. Reg. §1.1341-1(b)(2).

[87]. I.R.C. Sec. 1341(b)(4).


[90]. IRS Pub. 536, P2.

[91]. I.R.C. Reg. § 172-3(3).