



## It's Time to Fix the 'Traps for the Unwary'<sup>1</sup> in the Refund Statutes

by Leandra Lederman

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In 1995, I commented in this magazine on the confusion the Internal Revenue Code's statutes of limitations on refund claims were causing in the courts.<sup>2</sup> In 1996, the United States Supreme Court had its chance to fix the problem when it decided *Commissioner v. Lundy*,<sup>3</sup> but unfortunately it resolved only a part of it. Congress entered the fray last year, amending section 6512<sup>4</sup> to reverse *Lundy*,<sup>5</sup> but left other problems in the refund statutes unsolved, adding to the uncertainty. The time has come to clarify the statutory periods ap-

plicable to delinquent returns claiming refunds, both in and out of Tax Court. This article proposes an amendment to section 6511 that would provide a clear and uniform three-year period in the delinquent return context.

Section 6511 is the basic statute of limitations on claims for refund of tax. It provides:

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, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid. . . .<sup>6</sup>

A "limitation on amount" provision in section 6511(b) essentially provides that a taxpayer filing a timely claim can recover no more than the taxes paid within the two-year or three-year period preceding the claim, whichever is applicable.<sup>7</sup> By limiting recovery to amounts paid during the appropriate period, the statute assures, among other things, that a taxpayer cannot recover large amounts of withholding tax or estimated tax, both of which are deemed paid on the due date of the return,<sup>8</sup> by, for example, paying the IRS \$1 many years later, and then claiming a refund within two years of the \$1 payment.<sup>9</sup> That claim would be timely under section 6511(a), but recovery would be limited under section 6511(b) to \$1.

As was the case prior to *Lundy* and Congress's recent amendment to section 6512, section 6511 apparently does not contemplate delinquent returns claiming

<sup>1</sup>See *Richards v. Commissioner*, 37 F.3d 587, 588 n.3, 94 *TNT* 201-19 (10th Cir. 1994) ("Ms. Richards argues the tax court statutes are 'traps for the unwary.' We find little difficulty agreeing with this characterization relative to the entire scheme of limitations on taxpayer refunds at issue in this case. Having reviewed Congress' various attempts over the last 60 years to draft limitations on refund claims, we find the present state of the law still leaving something to be desired.").

<sup>2</sup>Leandra Lederman Gassenheimer, "Applying the Refund Statutes to Delinquent Returns," *Tax Notes*, Sept. 25, 1995, p. 1639.

<sup>3</sup>116 U.S. 235, *Doc* 96-1804 (33 pages); 96 *TNT* 12-10 (1996).

<sup>4</sup>See P.L. 105-34, sec. 1282, 111 Stat. 788 (1997).

<sup>5</sup>However, because the amendment is effective only for claims for refund filed after the date of the act, the Tax Court is bound by *Lundy* for prior years. See *Maxwell v. Commissioner*, T.C. Memo. 1998-74, *Doc* 98-7107 (5 pages), 98 *TNT* 36-13.

<sup>6</sup>Section 6511(a). Section 6511(b)(1) adds that "No credit or refund shall be allowed or made after the expiration of the period of limitation prescribed in subsection (a) for the filing of a claim for credit or refund, unless a claim for credit or refund is filed by the taxpayer within such period." All section references are to the Internal Revenue Code of 1986, as amended.

<sup>7</sup>Section 6511(b).

<sup>8</sup>Section 6513.

<sup>9</sup>The limitation on amount dates back to a time when there was only one limitation period, measured from the time the tax was paid, and was included for this reason. See Senate Finance Committee, S. Rep. No. 398, 68th Cong., 1st Sess. 33 (1924).

refunds.<sup>10</sup> However, claims for refund of income tax can only be made on returns.<sup>11</sup> Thus, a taxpayer who claims an income tax refund cannot be in the "no return was filed" situation.<sup>12</sup> Instead, that taxpayer is in a situation where his return and his refund claim are one and the same document. This creates ambiguity as to which statutory period applies to a taxpayer filing his first return for the year, claiming a refund, more than two years but less than three years after the due date of the return.

In this situation, there are basically two possibilities: (1) the taxpayer is considered to have filed "no return" and a claim filed more than two years from when the tax was paid is too late, or (2) he is considered to have filed the claim within three years of the return because both were filed on the same day, benefitting from the three-year lookback period. I argued previously that option (1) is more consistent with the language of section 6511. However, in Revenue Ruling 76-511, the IRS, relying in part on a Treasury regulation providing that a return claiming a refund constitutes a refund claim for purposes of section 6511,<sup>13</sup> found that a three-year period applied in this situation.<sup>14</sup>

Perhaps the revenue ruling should have definitely resolved the issue in the taxpayer's favor. However, the IRS has not always followed the revenue ruling's approach, arguing for a two-year period in several cases,<sup>15</sup> some of which it won.<sup>16</sup> In *Lundy*, the IRS argued before the Supreme Court that a two-year period would apply outside of Tax Court:

Lundy argues that the claim for refund he filed with his tax return . . . would have been timely for purposes of district court litigation because it was filed "within 3 years from the time the return was

filed," section 6511(b)(1) (incorporating by reference section 6511(a)); see also Rev. Rul. 76-511, 1976-2 Cum. Bull. 428, and within the 3-year lookback period that would apply under section 6511(b)(2)(A). Petitioner disagrees that there is any disparity, arguing that Lundy's interpretation of the statute is wrong and that Lundy's claim for refund would not have been considered timely in district court. See Brief for Petitioner 12, 29-30, and n.11 (citing *Miller v. United States*, 38 F.3d 473, 475 (CA9 1994)).<sup>17</sup>

In fact, both positions are overstated; prior to *Lundy*, most refund courts applied a three-year period under 6511, but courts in the Ninth Circuit consistently applied a two-year period.<sup>18</sup>

**Congress entered the fray last year, amending section 6512 to reverse Lundy, but left other problems in the refund statutes unsolved, adding to the uncertainty.**

Although the *Lundy* court did not decide which period would apply outside of Tax Court,<sup>19</sup> Congress apparently accepted Lundy's argument as fact when it amended section 6512:

In *Commissioner v. Lundy*, 116 S. Ct. 647 (1996), the taxpayer had not filed a return, but received a notice of deficiency within 3 years after the date

<sup>10</sup>See *Commissioner v. Lundy*, note 3 *supra*, at 255 (Thomas, J., dissenting) ("Congress' intent on this issue is difficult to discern. There is reason to think that Congress simply did not consider how being delinquent in filing a return would affect a taxpayer's right to recover a refund — in any forum.").

<sup>11</sup>Treas. reg. section 301.6402-3(a).

<sup>12</sup>A refund of other taxes is claimed on Form 843. Treas. reg. section 301.6402-2(c).

<sup>13</sup>A properly executed individual, fiduciary, or corporation income tax return or credit shall, at the election of the taxpayer, constitute a claim for refund within the meaning of section 6402 and section 6511 for the amount of the overpayment disclosed by such return. For purposes of section 6511, such claim shall be considered as filed on the date on which such return is considered as filed . . . .

Treas. reg. section 301.6402-3(b)(4).

<sup>14</sup>Rev. Rul. 76-511, 1976-2 C.B. 428.

<sup>15</sup>See, e.g., *Oropallo v. United States*, 994 F.2d 25, 93 TNT 114-11 (1st Cir. 1993) ("The government urges us to affirm the district court's implicit holding that the two-year limitations period for nonfiling taxpayers applies and that Oropallo's late return is not a 'return' which triggers application of the three-year limitations period."), *cert. denied* 510 U.S. 1050 (1994); *Edgmon v. Commissioner*, T.C. Memo. 1990-344 ("Respondent contends, however, that overpayments of petitioner's excess withholding credits are precluded by the bar of limitations because the returns were not filed within two years of the dates on which they were due.").

<sup>16</sup>See note 18 and accompanying text, *infra*.

<sup>17</sup>*Commissioner v. Lundy*, note 3 *supra*, at 251-52.

*Miller v. United States* reflects the Ninth Circuit's position that a two-year period applies to bar refund claims made within the third year after the return was due. See *Miller v. United States*, 38 F.3d 473, 94 TNT 213-59 (9th Cir. 1994). Its analysis is based on the understanding that the two-year period would apply in Tax Court in this situation and that it would be inappropriate to have a shorter period apply in Tax Court than in refund courts. *Id.* at 476. In fact, Congress has subsequently provided for a three-year period in this very situation, see section 6512(b), and, in addition, it would not necessarily be inappropriate to apply a two-year period to someone whose nonfiling is "caught" by the IRS and sent a notice of deficiency, but allow a three-year period for those who voluntarily (albeit delinquent) comply with the duty to file a return.

<sup>18</sup>Compare *Webb v. United States*, 66 F.3d 691, 700, 95 TNT 196-11 (4th Cir. 1995) (three-year period under section 6511); *Oropallo v. United States*, note 15 *supra* at 31 n. 7 (*dictum*), *cert. denied* (*dictum*) 510 U.S. 1050 (1994); *Mills v. United States*, 805 F. Supp. 448, 450 (E.D. Tex. 1992); *Radin v. United States*, 702 F. Supp. 38 (D. Conn. 1988), with *Brockamp v. United States*, 67 F.3d 260, 261, 95 TNT 199-5 (9th Cir. 1995) (*dictum*) (two-year period under section 6511), *aff'd on other grounds* 517 U.S. 1232 (1996); *Miller v. United States*, note 17 *supra*; *Musser v. United States*, 92-1 U.S.T.C. para. 50,245 (D. Alaska 1991) (unpublished), *aff'd on other grounds* 8 F.3d 28, 93 TNT 229-46 (9th Cir. 1993) (unpublished); *Swannack v. Internal Revenue Service*, 92-1 U.S.T.C. para. 50,082, 92 TNT 32-45 (W.D. Wash. 1991) (unpublished); *Arnzen v. Internal Revenue Service*, 91-1 U.S.T.C. para. 50,020, 90 TNT 264-20 (W.D. Wash. 1990); *Allen v. United States*, 439 F. Supp. 463, 464 (C.D. Cal. 1977) (*dictum*).

<sup>19</sup>The Supreme Court assumed without deciding that Lundy was correct in his argument that a three-year period would apply outside of Tax Court. See *Lundy*, note 3 *supra* at 252.

the return was due and challenged the proposed deficiency in Tax Court. The Supreme Court held that the taxpayer could not recover overpayments attributable to withholding during the tax year, because no return was filed and the 2-year 'look back' rule applied. Since overwithheld amounts are deemed paid as of the date the taxpayer's return was first due (i.e., more than 2 years before the notice of deficiency was issued), such overpayments could not be recovered. *By contrast, if the same taxpayer had filed a return on the date the notice of deficiency was issued, and then claimed a refund, the 3-year 'look back' rule would apply, and the taxpayer could have obtained a refund of the overwithheld amounts.*<sup>20</sup>

As a result, Congress amended section 6512(b)(3) to provide for a three-year period in the situation where the taxpayer has not filed a return but receives a notice of deficiency during the third year after it was due, and petitions the Tax Court, seeking a refund of an overpayment of taxes deemed paid on the due date of the return. The amendment provides:

In a case described in subparagraph (B) where the date of the mailing of the notice of deficiency is during the third year after the due date (with extensions) for filing the return of tax and no return was filed before such date, the applicable period under subsections (a) and (b)(2) of section 6511 shall be 3 years.<sup>21</sup>

As explained below, because of the statutory structure, this amendment does not resolve the underlying question of which period should apply under section 6511, and does not even resolve the period applicable under section 6512(b) in all Tax Court cases.

Section 6512(b)(1) provides the Tax Court with jurisdiction to determine an overpayment in a case in which the taxpayer has received a notice of deficiency and timely petitioned the Tax Court.<sup>22</sup> Section 6512(b)(3) provides the statute of limitations.<sup>23</sup> In general, the rules of section 6512(b)(3) attempt to assure limitations periods comparable to those applicable to refund claims that are not litigated in Tax Court by limiting amounts recoverable to those recoverable under section 6511.<sup>24</sup> In any case where the taxpayer has not filed a claim prior to the mailing of the notice of deficiency,

and has not paid tax after the notice was mailed, the rules of section 6512(b)(3)(B) apply. That subsection looks at whether, as of the date the notice of deficiency was mailed, a (hypothetical) refund claim filed by the taxpayer would have been timely, and limits amounts recoverable in Tax Court to those that would have been recoverable under section 6511.

***Following Lundy and the amendment to section 6512, there is disagreement on whether the two-year or three-year period applies under section 6511 where the original, delinquent return serves as a refund claim.***

The amendment to section 6512 does not resolve the period applicable under section 6512(b)(3)(C) to a taxpayer who filed a delinquent return claiming a refund in the third year after it was due, and then received a notice of deficiency in response to which he petitioned the Tax Court. Under section 6512(b)(3)(C), where a refund claim was filed before the notice of deficiency was mailed, amounts recoverable are those that would be recoverable under section 6511(b) if (1) either the claim had not been disallowed before the deficiency notice was mailed; (2) the claim had been disallowed, but a timely refund suit could have been commenced before the notice was mailed; or (3) a timely refund suit actually was commenced before the notice was mailed.<sup>25</sup> Because a prerequisite to court jurisdiction is a timely refund claim,<sup>26</sup> in each instance referred to in section 6512(b)(3)(C), amounts recoverable under section 6511 are limited to those recoverable under section 6511(b) where the claim was timely filed under section 6511(a). The amendment to section 6512 does not resolve which period applies under section 6511.<sup>27</sup> Thus, even in this Tax Court situation, the outcome is still uncertain. In fact, the amendment will likely have little practical significance at all because the IRS can preclude its applicability to the one situation it would apply to by waiting at least three years after the return was due to send a notice of deficiency to a nonfiler, rather than waiting only two years. The notice of deficiency will be timely because the statute of limitations on assessment does not start to run until a return was filed.<sup>28</sup>

<sup>20</sup>House Rpt. 105-220 (1997) (emphasis added).

<sup>21</sup>Section 6512(b)(3).

<sup>22</sup>Section 6512(b)(1).

<sup>23</sup>See section 6512(b)(3) (limiting credit or refund availability to amounts paid within certain time periods).

<sup>24</sup>See section 6512(b)(3)(B) (amounts recoverable are those that would be recoverable under section 6511(b)(2), (c), or (d) if a refund claim had been filed on the date the notice of deficiency was mailed), (C) (where a refund claim was filed before the notice of deficiency was mailed, amounts recoverable are those that would be recoverable under section 6511(b)(2), (c), or (d) if either, the claim had not been disallowed before the deficiency notice was mailed, the claim had been disallowed, but a timely refund suit could have been commenced before the notice was mailed, or a timely refund suit actually was commenced before the notice was mailed). The only situation in which the section 6512(b)(3) limitation on amount does not look to section 6511 is with respect to amounts paid after the notice of deficiency was mailed. See section 6512(b)(3)(A).

<sup>25</sup>Section 6512(b)(3)(C).

<sup>26</sup>Section 7422(a).

<sup>27</sup>*Cf. Phillips v. Commissioner*, T.C. Memo. 1993-349, 93 TNT 168-13 (pre-Lundy case in which the court stated that the taxpayer's delinquent/return was timely filed under the three-year rule of section 6511(a) because the return and refund claim were one document, but the limitation on amount of 6511(b), as incorporated through section 6512(b)(3)(C), precluded recovery because all amounts were paid more than three years prior to the filing of the claim, thus resulting in lack of Tax Court jurisdiction to determine an overpayment).

<sup>28</sup>Section 6501(c)(3) (IRS can assess tax "at any time" where no return was filed).

Because section 6512 applies only in Tax Court, the amendment also provides no indication of what the applicable period should be under section 6511, where a taxpayer has claimed a refund without receiving a deficiency notice and petitioning the Tax Court. Following *Lundy* and the amendment to section 6512, there is disagreement on whether the two-year or three-year period applies under section 6511 where the original, delinquent return serves as a refund claim. Four district courts facing the issue applied a three-year statute,<sup>29</sup> only one of which cited Revenue Ruling 76-511,<sup>30</sup> and the Ninth Circuit has continued to apply a two-year period, most recently on the erroneous theory that an untimely return is not a valid return.<sup>31</sup>

Taxpayers need to know what the statutory period is for claiming a refund. Given Congress's recent reversal of *Lundy*, in favor of a pro-taxpayer three-year rule applicable to taxpayers in the *Lundys'* situation, the uniform principle should be that taxpayers benefit from the three-year statutory period whenever they file a delinquent return serving as a refund claim (unless the two-years-from-payment period is longer). That way, those who voluntarily file a delinquent return claiming a refund would be no worse off than those "caught" by the IRS. It would also be consistent with Revenue Ruling 76-511.<sup>32</sup> The amendment to section

<sup>29</sup>See *Video Training Source, Inc. v. United States*, 1998 U.S. Dist. LEXIS 1068 (D. Col. Jan. 28, 1998) ("VTS filed its 1990 return on October 26, 1994. Because VTS's delinquent return is also its refund claim, VTS has filed its refund claim within three years from the time the return was filed. I.R.C. section 6511(a)."); *Sy v. United States*, 968 F. Supp. 345, 347 (E.D. Mich. 1997) (IRS admitted timeliness under section 6511(a)); *Weisman v. IRS*, 972 F. Supp. 185, 188, *Doc 97-21569 (9 pages)*, 97 TNT 142-10 (S.D.N.Y. 1997) ("Plaintiff here satisfies the first limitation because he filed his 1983 return and refund claim together. With regard to the second limitation, Plaintiff is deemed to have paid the 1983 tax, through withholding, on April 15, 1984. . . . Plaintiff, therefore, must have filed the 1983 tax refund claim no later than April 15, 1987 (i.e., within three years after April 15, 1984) to satisfy the requirement of Section 6511(b)(2)(A).") (citation omitted); *Poindexter v. IRS*, 79 AFTR 2d para. 97-895 (E.D. Pa. 1997), *Doc 97-13787 (10 pages)*, 97 TNT 97-10 ("As stated previously, defendant concedes that plaintiff's tax return reflecting an overpayment of tax constitutes a claim for refund. See *infra* note 1. Her claim for refund thus was filed 'within three years from the time the return was filed' because, as they are one and the same, the claim for refund and the tax return were filed simultaneously.").

<sup>30</sup>See *Video Training Source, Inc. v. United States*, note 30 *supra*.

<sup>31</sup>*Ott v. United States*, 81 AFTR 2d para. 98-615, *Doc 98-12813 (9 pages)*, 98 TNT 76-10 (9th Cir. 1998) ("If a taxpayer has filed a valid return, his claim for refund must 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 the later.' 26 U.S.C. section 6511(a). Because Ott's 1987 return was not timely, it does not qualify as a valid return under section 6511(a).") (citing *Miller v. United States*, note 17 *supra*, at 475). *But cf.* Treas. reg. section 301.6402-3(a)(1) ("In general, in the case of an overpayment of income taxes, a claim for credit or refund of such overpayment shall be made on the appropriate income tax return.").

<sup>32</sup>The "no return was filed" language of section 6511 would accordingly apply only to tax refunds claimed on Form 843, not on a return, that is, taxes other than income taxes. See note 12, *supra*.

6511 could be in the form of an additional sentence at the end of subsection (a), and could read as follows:

If the taxpayer's refund claim is also the taxpayer's return, and no return was filed prior to the taxpayer's refund claim, the refund claim is considered to be filed within three years from the time the return was filed, whether or not the return was timely filed.

This amendment would allow a taxpayer's delinquent return claiming a refund of taxes deemed paid on the due date of the return to be timely if filed anytime up to and including the date three years from the due date of the return, but would not preclude the taxpayer from recovering within two years of payment any payments made after the due date of the return, if the two-year period is longer.<sup>33</sup>

<sup>33</sup>This amendment should also clarify that a delinquent return is still a "return." Thus, for example if the taxpayer filed his 1994 return May 1, 1995, and received May 5, 1995, he would have until May 5, 1998 (three years from when the return was filed) to recover amounts paid with the late-filed 1994 return. *Cf.* Gassenheimer, "Applying the Refund Statutes to Delinquent Returns," note 2 *supra*, Situation 10.

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