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The Tax Court's Recent Determination That a Taxpayer Did Not Meet the Three-Factor Test for Informal Refund Claims and a Review of Cases in Which Courts Have Treated a Refund Request Made on an Incorrect Form as an Informal Refund Claim

Section 6511(a) requires a taxpayer seeking a refund to file a claim within three years from the time of filing the relevant return or two years from the time of payment of the tax, whichever period expires later. Treas. Reg. § 301.6402-2 sets forth the requirements for a valid refund claim, including that the taxpayer submit the claim on the proper form and set forth in detail all grounds upon which the credit or refund is claimed and all facts sufficient to apprise the IRS of their exact basis. Despite these requirements for making a refund claim, courts have held that, under certain circumstances, it is sufficient if the taxpayer submits an informal claim within the refund limitation period and then submits a formal claim outside the refund statute.

In determining whether a taxpayer has made a timely informal refund claim, the Tax Court applies a three-factor test. First, there must be a written component to the claim that is delivered to the IRS before the expiration of the refund statute. Second, the writing, in conjunction with the surrounding circumstances, must adequately notify the IRS that the taxpayer is claiming a refund and the basis for it. Third, either the IRS waives the procedural defects of the informal refund claim by considering the claim on its merits, or the taxpayer

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subsequently perfects it by filing a formal refund claim before the IRS rejects the informal refund claim.[1]

Several cases have addressed situations in which taxpayers who filed a form other than the proper refund claim form with the IRS have argued that they filed an informal claim. In *Palomares v. Comm'r*, T.C. Memo. 2014-243, the Tax Court recently considered whether a taxpayer filed a timely informal refund claim when the taxpayer attempted to request a refund by filing Form 8379, *Injured Spouse Allocation*. In response, the IRS sent the taxpayer a letter advising her that the correct form to request innocent spouse relief was Form 8857, *Request for Innocent Spouse Relief*. No investigation was done on the taxpayer's submission, and she did not file the proper refund claim form until after the refund statute of limitations had expired for some of the years for which she sought a refund. Because the request on Form 8379 was the only request taxpayer filed before the deadline, she asked the court to treat it as an informal refund claim. The court concluded the Form 8379 was not a valid informal refund claim because it did not identify the year for which a refund was sought and, therefore, did not adequately apprise the IRS of the refund requested.

In *Kaffenberger v. United States*, 314 F.3d 944 (8th Cir. 2003), the taxpayers succeeded in having Form 4868, *Application for Automatic Extension of Time To File US Individual Income Tax Return*, treated as an informal refund claim.[2] On their 1988 income tax return, the taxpayers elected to credit the 1988 overpayment to the 1989 tax year. However, a subsequent refund notice led them to believe that the credit had not been applied to the 1989 tax year, and that it was available for the 1990 tax year. As a result, when the taxpayers filed Form 4868 to extend the filing deadline for the 1990 tax year, they included the 1988 overpayment on the "other payments and credits" line. Although the taxpayers made estimated tax payments for the 1989 tax year, they did not file a timely tax return. The IRS filed a 1989 tax return for the taxpayers and applied the 1988 overpayment, resulting in an overpayment for the 1989 tax year. The taxpayers were initially assured that the 1989 overpayment would be applied to the tax liability for the 1990 tax year, but the IRS later declined to apply the 1989 overpayment because the refund statute of limitations for the 1989 tax year had expired. The IRS took the position that the late 1989 return was an untimely formal refund claim, so the taxpayers argued that the 1990 Form 4868 was a timely informal claim. The court held that the Form 4868, in conjunction with the taxpayers' other filings and associated IRS correspondence, gave the IRS sufficient notice of the refund request. In doing so, the court emphasized that all facts and circumstances, not just the written component, should be considered when evaluating an informal refund claim.

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[1] *Jackson v. Comm'r*, T.C. Memo. 2002-44.

[2] Another taxpayer who tried to make an informal claim on Form 4868 was not so fortunate. In *Khinda v. Comm'r*, T.C. Memo. 1994-617, the taxpayer's Form 4868 for 1990 included an estimate of his tax liability for the year. Several years later, the taxpayer filed a late return in which a formal request for refund was included. Because the formal request was filed after the deadline, the taxpayer argued that the Form 4868 was an informal refund claim and the late return perfected the claim. The Tax Court disagreed, holding that Form 4868 "does not provide the Commissioner sufficient notice that the taxpayer is claiming a refund. Rather, it simply provides an estimate of tax liability."

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In *American Radiator & Standard Sanitary Corp. v. United States*, 318 F.2d 915 (Ct. Cl. 1963), the taxpayer included various notations and figures on its 1949 Form 1120, *United States Corporation Income Tax Return*, that it argued served as an informal refund claim for prior years. After the statute of limitations for refund had expired, the taxpayer filed formal refund claims with respect to the items identified on its 1949 tax return. The IRS rejected the claims, and the taxpayer filed suit. The Court of Claims held that the notations and figures on the 1949 tax return, along with the knowledge of the IRS agent who had examined the taxpayer's return for that year, were sufficient to satisfy the writing and notice requirements of the informal claim doctrine. Although certain details of the basis for the refund claim were missing from the notations and figures, the formal refund claims submitted by the taxpayer supplied that information and, thus, the informal claim was perfected prior to the IRS's rejection.

Taxpayers who may have missed a deadline for a formal refund claim may want to examine whether any of their filings with the IRS, in conjunction with their other communications, contain sufficient detail to be considered an informal refund claim. A timely filed informal refund claim will generally need to be perfected by filing of a formal refund claim filed outside the statute of limitations.

The Tax Court Reforms Faulty Assessment Statute of Limitations Extensions

Under section 6501(a), the Internal Revenue Service ("IRS") generally has three years from when a return is filed to assess tax. The three-year period may be extended by agreement, under section 6501(c)(4), with Form 872, *Consent to Extend the Time to Assess Tax*. Some taxpayers have challenged the validity of a Form 872 based on an error made on the form, and there is a line of cases where the Tax Court has applied the doctrine of reformation to fix those errors so that the Forms 872 reflect the parties' intent.[3] Reformation is an equitable remedy that can be used to correct contracts when, due to a scrivener's error, a writing does not conform to the intention of the parties. Reformation prevents either party from experiencing an unintended benefit, and reforms a contract to reflect the real agreement between the parties. In order to reform a Form 872, there must be clear and convincing evidence of the parties' intent.[4]

Recently, in *Hartland Mgmt. Servs. v. Comm'r*, 2015 Tax Ct. Memo LEXIS 20, the IRS asked the Tax Court to reform Forms 872, so as to properly reflect the tax years for which the IRS asserted the parties intended to extend the assessment statutes of limitations. The Tax Court agreed, finding that the parties' original intent had been to extend the assessment statutes for the years identified by the IRS.

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[3] *See San Francisco Wesco Polymers, Inc. v. Comm'r*, T.C. Memo. 1999-146; *Buchine v. Comm'r*, T.C. Memo. 1992-36, *aff'd* 20 F.3d 173 (5th Cir. 1994); *Kelley v. Comm'r*, T.C. Memo. 1990-158; *Atkinson v. Comm'r*, T.C. Memo. 1990-37; *Woods v. Comm'r*, 92 T.C. 776 (1989).
[4] *Woods*, 92 T.C. at 789 n.14.

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In *Hartland*, the errors on the Forms 872 arose while the IRS was examining petitioners'[5] returns for the 2008 and subsequent tax years.[6] As the assessment statutes of limitations for the 2008-2009 tax years were nearing expiration, the IRS prepared and delivered Forms 872 to the petitioners. The forms were faulty in that they did not correctly identify the tax years for which the assessment statutes were to be extended; instead, the Forms 872 reflected the dates on which the assessment statutes of limitations expired for the tax years the IRS sought to extend.[7] The petitioners signed and returned the faulty Forms 872, and the IRS continued the examination. During the exam process, the petitioners participated in negotiations with the IRS. Those negotiations included a year for which the statute of limitations would have expired but for the Form 872. The IRS prepared another set of Forms 872 to extend the assessment statutes of limitations for an additional year and delivered them to petitioners. This time, the forms correctly listed the tax years for which the assessment statutes were to be extended. Petitioners refused to sign the forms, the IRS issued notices of deficiency, and the issue was brought before the Tax Court. Petitioners argued that the 2008-2009 tax years were closed under section 6501(a), and no agreements to extend the assessment statutes of limitations for those years were ever signed. The IRS argued that the parties had intended for the faulty Forms 872 to extend the assessment statutes of limitations for the 2008-2009 tax years, and asked the court to reform them.

Because neither party submitted any testimony, the Tax Court was forced to infer their intent from the stipulated facts and exhibits. Based on that record, the court determined that a mutual mistake had been made. The court found it persuasive that petitioners' counsel was knowledgeable about federal tax law and procedure and knew, or should have known, that the years for which extensions were sought would be those whose assessment statutes of limitations were closest to expiration. Additionally, the court determined that the parties did not intend to extend the assessment statutes of limitations for the tax years stated on the Forms 872 because, not only were those years still open at the time the Forms 872 were signed, but the tax year end dates listed on the Forms 872 did not correspond to petitioners' actual tax year end dates. Finally, as evidence of the parties' intent to extend the assessment statutes of limitations for the 2008-2009 years, the court looked at petitioners' subsequent actions, including their continued participation in the negotiations even after the three-year assessment statute of limitations for one of the years had expired. As a result, the court reformed the Forms 872 to extend the statutes of limitations for the 2008-2009 tax years, thereby allowing the IRS to assess deficiencies for those years.

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[5] This is a consolidated case with three petitioners: Hartland Management Services Inc., Integra Engineering, Ltd., and Craig and Kim Kunkel.
[6] The relevant years at issue in this case were Integra's tax year ended November 30, 2008, the Kunkels tax year ended December 31, 2008, and Hartland's tax year ended May 31, 2009 (the "2008-2009 tax years").
[7] The assessment statutes of limitations for the 2008-2009 tax years ended February 15, 2012, April 15, 2012, and August 15, 2012, respectively.

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IRS Issues Email Advice Specifying the Application of the *Ex Parte* Rules to Docketed versus Non-Docketed Cases

The Commissioner is responsible for ensuring an independent Appeals function within the Internal Revenue Service ("IRS"). To that end, the Department of the Treasury and the IRS have issued revenue procedures to communicate the IRS's business practices and prohibitions on *ex parte* communications between Appeals officers and other IRS employees to the extent that such communications appear to compromise the independence of the Appeals officers. In 2012, the IRS published Rev. Proc. 2012-18 to provide guidance on the permissible and impermissible *ex parte* communications between Appeals and other IRS employees.

An "*ex parte* communication" is defined as a "communication that takes place between any Appeals employee (e.g., Appeals Officers, Settlement Officers, Appeals Team Case Leaders, Appeals Tax Computation Specialists) and employees of other IRS functions, without the taxpayer/representative being given an opportunity to participate in the communication," and includes both oral and written communications.[8] An *ex parte* communication does not include, among other things, communications among Appeals employees or communications between Appeals employees and employees of other governmental entities.[9] Additionally, not all *ex parte* communications are prohibited, such as those regarding ministerial, administrative, or procedural matters.[10] Finally, there is an exception to the ex parte communication rules for communications between Appeals and IRS Counsel in connection with cases that are docketed in the Tax Court.[11]

On January 23, 2015, the IRS Office of Chief Counsel released an email communication, CCA 201504016 ("CCA"), in response to a question as to whether Appeals is required to follow the *ex parte* communication rules when it is coordinating the settlement of an Appeals case with IRS Counsel when there is a related case in Counsel jurisdiction. The CCA concluded that if the substantive communication between Appeals and Counsel concerning the terms of the proposed Appeals settlement pertains to a case that is docketed in the Tax Court, then this would fall under the exception to the *ex parte* rules. By contrast, if the substantive communication pertains to a non-docketed case, then the *ex parte* rules are required to be observed. The CCA noted that the Internal Revenue Manual section 8.4.1.17.1 provides that, in general, Appeals should coordinate with IRS Counsel when settling a case for which a related case is pending in Counsel jurisdiction, but does not make a distinction between docketed versus non-docketed cases, and that the Manual has not been updated since the issuance of Rev. Proc. 2012-18.

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[8] Rev. Proc. 2012-18 Sec. 2.01(1).
[9] Rev. Proc. 2012-18 Sec. 2.01(1)(a).
[10] Rev. Proc. 2012-18 Sec. 2.03(2).
[11] Rev. Proc. 2012-18 Sec. 2.06(2)(a).

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The IRS Issued Rev. Proc. 2015-13, which Significantly Modifies the Procedures Applicable to Taxpayers under Examination Filing Accounting Method Changes

On January 16, 2015, the IRS released Rev. Proc. 2015-13 and Rev. Proc. 2015-14, thereby providing new procedures for changing tax methods of accounting. Rev. Proc. 2015-13 generally supersedes Rev. Proc. 97-27 and Rev. Proc. 2011-14 ("prior method change procedures") with respect to the procedures and terms and conditions that a taxpayer must apply in making a voluntary method change in accordance with IRC § 446(e). Under transition rules, a taxpayer has the option of filing a method change for a tax year ended on or after May 31, 2014 or on or before January 31, 2015, under either new method change procedures or under Rev. Proc. 2011-14.

The rules for filing changes in method of accounting for taxpayers not under IRS examination essentially are unchanged. Thus, a taxpayer that is not under IRS examination and voluntarily files a request for change in accounting method continues to receive favorable terms and conditions, including a prospective year of change, a four-year spread of an unfavorable § 481(a) adjustment, and audit protection.

Special Rules for Taxpayers under Exam

Generally: The rules for determining whether a taxpayer is under examination for purposes of applying Rev. Proc. 2015-13 are generally the same as under prior procedural guidance – the taxpayer is under examination when it is contacted in any manner by an IRS representative for the purpose of scheduling or conducting any examination of the federal income tax return. Consistent with prior procedures, an examination ends generally (1) when a "no change" letter is sent to the taxpayer, (2) in a fully agreed case, the earliest of – execution of waiver of restrictions, the date the taxpayer pays the deficiency amount, or the date of the final "closing" letter, or (3) in an unagreed or partially agreed case, at the earliest of – the transferred to appeals, the date the taxpayer files a petition in the Tax Court, the date the period for filing with the Tax Court expires, or the date the final notice of claim disallowance. As under the prior guidance, special rules apply for taxpayers before the Joint Committee of Taxation.

The new guidance clarifies that a foreign corporation that is not required to file a federal income tax return is under examination if any of its controlling domestic shareholders (as defined in Treas. Reg. § 1.964-1(c)(5)) is under examination for a taxable year in which any such shareholder was a United States shareholder (as defined in IRC § 951(b) or IRC § 953(c)(1)(A)) of the foreign corporation. Additionally, for purposes of Rev. Proc. 2015-13, the foreign corporation is no longer under exam when all of its controlling domestic shareholders are no longer under exam.

Audit Protection: Under Rev. Proc. 2015-13, an otherwise eligible taxpayer that is under exam can file an accounting method change request under either the automatic or non-automatic procedures without back-year audit protection. However, if the taxpayer meets any of the following exceptions, the method change will have back-year audit protection:

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- **Three-month window (replaces the previous 90-day window):** A taxpayer (other than a controlled foreign corporation (“CFC”)) under continuous examination for 12 consecutive months may file a method change for an item that is not an issue under consideration during the period that begins on the 15th day of the 7th month following the end of the tax year and ends on the 15th day of the 10th month following the end of the tax year. Special rules apply to a CFC that require, a CFC’s controlling domestic shareholders that are under examination must be under examination for at least 24 consecutive months before the three-month window opens.
- **120-day window:** A taxpayer under examination may file within a 120-day period following the date an examination ends, regardless of whether a subsequent examination has commenced, providing the issue is not under consideration in an examination. However, a CFC can no longer use this window period.
- **Present method not before the director:** This exception applies to a taxpayer that is changing from a clearly permissible method to a clearly permissible method or changing from an impermissible method adopted subsequent to the year under examination to a clearly permissible method.
- **New member of consolidated group in CAP:** A corporation (not otherwise under examination) that becomes a member of a consolidated group that is under examination because it participates in the Compliance Assurance Process (“CAP”) to file a Form 3115, provided the issue is not under consideration in an examination.
- **Change resulting in a negative § 481(a) adjustment:** A taxpayer may make a method change (with back-year audit protection) if the change is made with a negative § 481(a) adjustment in the year of change and, that would have resulted in a negative § 481(a) adjustment if the change had been made in any of the tax years under exam. Note that this change can be made whether or not the item is an issue under consideration.
- **No examination imposed change and item not under consideration:** A taxpayer that files a method change while under examination (and is not eligible for any of the exceptions for back-year audit protection), receives back-year audit protection, if by the earliest date that any of the taxpayer’s examinations end, the examining agent has not proposed an adjustment for the same item that is the subject of the method change for the tax year(s) under examination, and the method is not an issue under consideration. For CFCs, there is a notification requirement that gives an examining agent a 90-day period during which the agent may propose an adjustment for the item that is the subject of the method change. Note that for method changes made under this exception, a positive § 481(a) adjustment is taken into account over 2 years (the year of change and the next subsequent tax year).

Effective Date

Subject to transition rules, the procedures are generally effective for accounting method changes filed on or after January 16, 2015, for tax years ending on or after May 31, 2014.

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