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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

DATED: November 8, 1999

MEMORANDUM FOR:

FROM: Elizabeth G. Beck  
Senior Technical Reviewer  
CC:INTL:6

SUBJECT:

This Field Service Advice responds to your memorandum dated July 12, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

LEGEND:

US Corp.	=
FSC1	=
a	=
b	=
c	=
d	=
e	=
f	=
g	=
h	=
Date A	=

Date B =  
Date C =  
Date D =  
Date E =  
Date F =  
Date G =  
Date H =  
Date I =  
Date J =  
Date K =  
Date L =  
Date M =  
Date N =  
Date O =  
Date P =  
Date Q =  
Date R =  
Date S =  
Date T =  
Date U =  
Date V =  
Tax Year A =

ISSUES:

1. Whether the refund period of limitation applicable to the related supplier was open when the FSC redetermination was filed.
2. Whether the Service's reduction of the related supplier's refund claim, based on certain examination-based deficiencies, constituted a "payment of tax" that would affect the refund period of limitation applicable to the related supplier.
3. Whether the refund period of limitation applicable to the FSC was open when the FSC redetermination was filed.
4. Whether the tender of additional tax by the FSC with the amended return altered the period of limitations applicable to the FSC.

CONCLUSIONS:

1. No. The refund period of limitation applicable to the related supplier had expired when the FSC redetermination was filed.
2. No. The Service's reduction in the related supplier's claim for refund by an offset of deficiencies in tax for the same tax year did not constitute a payment of tax, and did not affect the refund period of limitation applicable to the related supplier.
3. No. The refund period of limitation applicable to the FSC had expired when the FSC redetermination was filed.
4. No. The tender of additional tax by the FSC after expiration of the assessment period of limitation applicable to the FSC was a voluntary payment of tax. Moreover, the Service may refund that amount to the FSC, assuming the FSC filed a valid refund claim within two years of the payment.

FACTS:

USCorp. is a domestic corporation that files income tax returns on a 52/53 week, fiscal-year basis. USCorp.'s year-end for the tax year in question (Tax Year A) was Date A. FSC1 is a wholly-owned subsidiary of USCorp. and properly elected to be treated as a foreign sales corporation (FSC) within the meaning of section 922(a). USCorp. paid FSC1 a commission with respect to certain qualifying export transactions, and deducted those commissions on its income tax return (Form 1120). FSC1's tax year was concurrent with that of USCorp.

USCorp.

The due date of the corporate income tax return (Form 1120) of USCorp. for Tax Year A was Date B. Prior to Date B, USCorp. filed a Form 7004, Application for Automatic Extension of Time to File a Corporate Income Tax Return, which extended the due date of the return to Date C. USCorp. filed its Form 1120 on Date D, per the Service's date-received stamp on the return.

On Date E, USCorp. mailed to the Service an amended income tax return (Form 1120X) for Tax Year A. The Service received USCorp.'s Form 1120X on Date F. This first amended return claimed a refund of \$a, plus interest, based on a corrected calculation of alternative minimum tax (AMT) and a corresponding reduction in the estimated tax penalty.

On Date G, the Service began examination of USCorp.'s Tax Year A, which was completed on or about Date H. The Service determined to allow USCorp.'s claim for refund of \$a, as reflected on the first amended return of Date F. However,

the Service also determined a deficiency of \$b, which partially offset the \$a refund amount. Thus, the Service determined a net over-assessment of \$c with respect to USCorp.'s Tax Year A.

On Date I, USCorp. signed a Waiver of Restrictions on Assessment (Form 870). On Date J, USCorp. filed a Waiver of Statutory Notice of Claim Disallowance (Form 2297). The Service then refunded to USCorp. the net over-assessment of \$c on Date K.

On Date L, USCorp. executed a second amended return (Form 1120X) with respect to Tax Year A, and mailed it to the Service on Date M. The Service received this return on Date N. The second amended return claimed a refund of \$d, based on a redetermination of FSC commission deductions pursuant to Temp. Treas. Reg. § 1.925(a)-1T(e)(4).

### FSC1

The income tax return (Form 1120FSC) for FSC1's Tax Year A was due to be filed on Date B. FSC1 timely filed a Form 7004, which extended the filing date to Date C. The Service received the Form 1120FSC on Date O.

Simultaneously with the examination of USCorp.'s Form 1120, the Service examined the Form 1120FSC of FSC1 for the same tax year. The Service determined that FSC1 had over-reported tax of \$e, which amount the Service refunded to FSC1 on Date P.

On Date L, FSC1 executed an amended Form 1120FSC for Tax Year A, which FSC1 mailed to the Service on Date M. The Service received this amended return on Date Q. The amended return used the same methodology as the second amended Form 1120X filed by USCorp., and reported increased FSC commissions, additional tax due of \$f, and interest of \$g. The additional tax reflected a redetermination of FSC commission income pursuant to Temp. Treas. Reg. § 1.925(a)-1T(e)(4). FSC1 enclosed with its amended return a check for the additional tax plus interest, in the total amount of \$h.

To date, the Service has not assessed the additional tax of \$h, nor has it otherwise credited that amount to the account of FSC1. Rather, the Service cashed the check and placed the resulting amount in an unrelated "dump account."

On Date R, FSC1 filed a duplicate Form 1120FSC, which was substantially identical to the amended return filed on Date Q with respect to Tax Year A.

On Date S, FSC1 mailed a protective claim for refund to the Philadelphia Service Center, which presumably received the claim within several days of Date S.

On the day following Date S, FSC1 hand-delivered a copy of the refund claim to the International Examiner.

LAW AND ANALYSIS:

Section 6401(a) defines an “overpayment” of tax as any amount of tax that is assessed or collected after expiration of the period of limitation applicable to it. Section 6401(c) provides that no amount paid shall be considered to be an overpayment “solely by reason of the fact that there was no tax liability in respect of which such amount was paid.”

Section 6402(a) provides that, in the case of an overpayment of tax, the Service may credit the amount of the overpayment against any outstanding liability of the taxpayer, and refund the balance to the taxpayer. Treas. Reg. § 301.6402-2(a)(2) provides that a claim for refund must be filed with the service center serving the internal revenue district responsible for the return.

Section 6501(a) provides that, in general, the Service must assess tax within three years after the date the return was filed.

Section 6511(a) contains the general rule that a taxpayer must claim a credit or refund of an overpayment of tax prior to the later of: (a) three years after the date on which the first valid income tax return was filed, or (b) two years after the date on which the tax was actually paid.

The rules governing redeterminations of FSC commissions for tax years beginning before January 1, 1998, are contained in Temp. Treas. Reg. § 1.925(a)-1T(e)(4), which states:

(4) *Subsequent determination of transfer price, rental income or commission.* The FSC and its related supplier would ordinarily determine under section 925 and this section the transfer price or rental payment payable by the FSC or the commission payable to the FSC for a transaction before the FSC files its return for the taxable year of the transaction. After the FSC has filed its return, a redetermination of those amounts by the Commissioner may only be made if specifically permitted by a Code provision or regulations under the Code. Such a redetermination would include a redetermination by reason of an adjustment under section 482 and the regulations under that section or section 861 and § 1.861-8 which affects the amounts which entered into the determination. In addition, a redetermination may be made by the FSC and related supplier if their taxable years are still open under the statute of limitations for making claims for refund under section 6511 if they determine that a different transfer pricing

method or grouping of transactions may be more beneficial. Also, the FSC and related supplier may redetermine the amount of foreign trading gross receipts and the amount of the costs and expenses that are used to determine the FSC's and related supplier's profits under the transfer pricing methods. Any redetermination shall affect both the FSC and the related supplier. The FSC and the related supplier may not redetermine that the FSC was operating as a commission FSC rather than a buy-sell FSC, and vice versa.

Temp. Treas. Reg. § 1.925(a)-1T(e)(4) (emphasis added). The "related supplier" is a related party that directly supplies to a FSC property or services which the FSC disposes of in a transaction producing foreign trading gross receipts, or a related party which uses a FSC as a commission agent in a similar transaction. See Temp. Treas. Reg. § 1.927(d)-2T. In the case of a commission FSC, such as FSC1, the related supplier pays the FSC commissions for services provided by the FSC in connection with qualifying export transactions, which commissions are deductible by the related supplier. See I.R.C. § 925(b).

Section 1.925(a)-1T(e)(4) of the temporary regulations permits redeterminations by taxpayers with respect to transactions between a FSC and its related supplier. The regulation requires, as a condition-precedent to such a redetermination, that the refund periods of limitation under section 6511 be open with respect to both the FSC and the related supplier. Temp. Treas. Reg. § 1.925(a)-1T(e)(4); Union Carbide Corp. v. Commissioner, 110 T.C. 375 (1998). In addition, the redetermination must "affect" both the FSC and the related supplier. That is, the Service must be able to assess additional tax due with respect to the taxpayer (in this case the FSC) that is placed in a deficiency position as a result of the redetermination.

Treas. Reg. § 301.7502-1(e)(2) provides that, in the case of certain refund claims that must be filed with the Service within a specified period of time, timely mailing of the refund claim is deemed to constitute timely filing. That is, if a refund claim is received by the Service after the specified period for filing has expired, the claim is deemed to be timely filed if the taxpayer can demonstrate that it was mailed prior to expiration of the applicable time period.

Treas. Reg. § 1.6091-2(e)(2) provides that the amended income tax return of a corporation must be filed with the service center serving the internal revenue district responsible for that return.

#### Issue 1: Refund Period of Limitation as to USCorp.

In general, a refund claim must be filed by the earlier of: three years of the date the return was filed, or two years from the date the tax was paid. I.R.C.

§ 6511(a). When the refund period of limitation begins with the filing of a tax return, as in the present case, the three-year period runs from the date of filing of the initial return, provided that the return was complete and met basic statutory requirements (e.g., signature). Kaltreider Construction, Inc. v. United States, 303 F.2d 366 (3d Cir. 1962), cert. denied, 371 U.S. 877 (1962). Cf., Badaracco v. Commissioner, 464 U.S. 386 (1984) (three-year limitation period inapplicable where initial return was fraudulent, and amended return was non-fraudulent). For these purposes, a return that is filed prior to the due date, as extended, is deemed filed on the date of receipt by the Service. First Charter Financial Corp. v. United States, 669 F.2d 1342 (9<sup>th</sup> Cir. 1982).

Applying the above principles, the three-year refund period of limitation applicable to USCorp. began to run on Date D, i.e., the date on which USCorp.'s Form 1120 was received by the Service, pursuant to a previous request for extension. USCorp.'s second amended return, which included the refund claim, was mailed on Date M, and is deemed to have been filed on the date of receipt, Date N. Date N was more than three years after Date D. Moreover, USCorp. cannot point to the mailing date of Date M as a timely-mailing date, because that date was itself more than three years after Date D. See Treas. Reg. § 301.7502-1(e)(2). Thus, the section 6511 refund period of limitation applicable to USCorp.'s Tax Year A expired on Date T, and the second amended return, which was both mailed and filed after Date T, could not give rise to a valid FSC redetermination pursuant to Temp. Treas. Reg. § 1.925(a)-1T(e)(4).

#### Issue 2: Reduction of Refund Amount as "Payment of Tax"

The taxpayer may argue that the Service's reduction of USCorp.'s first refund claim was a "payment of tax," sufficient to invoke section 6511. If that were the case, the refund period of limitation for USCorp. might have been open when the FSC redetermination was filed on Date M, thereby satisfying one of the requirements in Temp. Treas. Reg. § 1.925(a)-1T(e)(4). However, offset by the Service of individual adjustments on a single tax return for a single tax liability has been held not to constitute a "payment of tax" within the meaning of section 6511. Rather, such an offset is an intermediate computation, necessary to determine the taxpayer's ultimate liability for the year in question. Mobil Oil Corp. v. United States, 991 F.2d 811 (Fed. Cir. 1993); Republic Petroleum Corp. v. United States, 613 F.2d 518 (5<sup>th</sup> Cir. 1980); Kingston Products Corp. v. United States, 368 F.2d 281 (Cl. Ct. 1966).

USCorp.'s first amended return for Tax Year A corrected an error in calculation of Alternative Minimum Tax (AMT) contained in USCorp.'s initial return. The Service "netted" the claimed AMT overpayment of \$a against the examination-based deficiency of \$b, resulting in an over-assessment for Tax Year A of \$c, which amount was refunded to USCorp. The Service's offset of the deficiency against the

refund was a mathematical computation, as opposed to a “payment of tax.” As such, the reduction of the refund due to USCorp. for Tax Year A does not alter our conclusion (above) that the refund period of limitation applicable to USCorp.’s Tax Year A had already expired when the FSC redetermination was filed.

Because the refund period of limitation with respect to USCorp. had already expired when the FSC redetermination was filed, the requirement in Temp. Treas. Reg. § 1.925(a)-1T(e)(4) that the refund period of limitation be open with respect to the related supplier was not satisfied. The Service should reject the proposed redetermination.

In the interest of addressing all arguments that may arise in this case, we also evaluate whether the refund period of limitation applicable to FSC1 was open at the time of the redetermination (Issues 3 and 4, below).

### Issue 3: Refund Period of Limitation as to FSC1

FSC1 filed its initial Form 1120FSC for Tax Year A on Date O. Pursuant to I.R.C. § 6511(a), the three-year refund period of limitation for that return expired on Date U. FSC1’s amended Form 1120FSC, which incorporated the refund claim, was deemed filed on Date Q, which was more than three years after the date of the initial return. The mailing date of the refund claim (Date M) was likewise outside the three-year limitation period (which began on Date O), so the timely-mailing rule of Treas. Reg. § 301.7502-1(e)(2) is inapplicable. Therefore, the FSC redetermination failed to satisfy the requirement in Temp. Treas. Reg. § 1.925(a)-1T(e)(4) that the refund period of limitation applicable to the FSC be open at the time of the redetermination. This constitutes an additional basis for the Service to reject the FSC redetermination for Tax Year A.

### Issue 4: Voluntary Payment of Tax by FSC1

Together with the amended Form 1120FSC filed on Date Q, FSC1 tendered to the Service a check for \$h, consisting of additional tax of \$f and interest of \$g. These amounts reflected additional FSC commission income of FSC1, as shown on the amended Form 1120FSC. This voluntary payment by FSC1, which was made after the assessment period of limitation had expired, had no effect on the FSC redetermination under Temp. Treas. Reg. § 1.925(a)-1T(e)(4). The relevant refund period of limitation for that purpose pertains to the initial tax return, that is, the Form 1120FSC filed by FSC1. As noted above, the refund period of limitations for that return had already expired on Date U.



When FSC1 paid additional tax for Tax Year A, the assessment period of limitation applicable to FSC1 had already expired, as more than three years had elapsed from the filing date of the initial Form 1120 FSC (i.e., Date O). The Service had no authority to assess the additional amount tendered by FSC1, and did not perform such an assessment.

When a taxpayer voluntarily pays tax after the assessment period of limitation expires, the taxpayer is entitled to a refund. Ewing v. United States, 914 F.2d 499, 505 (4<sup>th</sup> Cir. 1990), cert. denied, 500 U.S. 905 (1991); Diamond Gardner Corp. v. Commissioner, 38 T.C. 875, 881 (1962); see also Rev. Rul. 74-580, 1974-2 C.B. 400. In such cases, the Service must refund the additional tax paid, assuming that the taxpayer makes a valid refund claim during the two-year limitation period, measured from the date of payment. See generally I.R.M. § 403(26).1 (the Service may accept “voluntary” payments of tax after expiration of statute of limitations, but may not assess with respect to such payments, and must inform the taxpayer of his right to obtain a refund of these amounts within the applicable limitation period). FSC1 was entitled to claim a refund of the \$h paid on Date Q within two years of payment, or until Date V. The Service should grant FSC1's refund claim, but only if that claim was filed prior to Date V, and otherwise conformed with all requirements for a refund claim. See I.R.C. § 6511(a); see also Treas. Reg. § 301.6402-2(a)(2) (place-of-filing requirement).

### Summary

The FSC redetermination failed to satisfy the requirement in Temp. Treas. Reg. § 1.925(a)-1T(e)(4) that the refund periods of limitation be open for the FSC and the related supplier as of the date of the redetermination. In fact, when the FSC redetermination was filed, the periods of limitation had expired with respect to both the FSC and the related supplier. Moreover, the Service's reduction of the refund due to USCorp., and FSC1's belated tender of additional tax, had no effect on the refund periods of limitation applicable to either USCorp. or FSC1. Accordingly, we recommend that you reject the FSC redetermination in its entirety.

Please call Branch 6 at (202) 874-1490 if you have any further questions.

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Branch 6