

January 2004

## Protective Claims for Refund: Protecting the Interests of Taxpayers and the IRS

Kristy M. Bowden  
*University of Maine School of Law*

Follow this and additional works at: <https://digitalcommons.mainerlaw.maine.edu/mlr>



Part of the [Taxation-Federal Commons](#), and the [Tax Law Commons](#)

---

### Recommended Citation

Kristy M. Bowden, *Protective Claims for Refund: Protecting the Interests of Taxpayers and the IRS*, 56 Me. L. Rev. 149 (2004).

Available at: <https://digitalcommons.mainerlaw.maine.edu/mlr/vol56/iss1/6>

This Comment is brought to you for free and open access by the Journals at University of Maine School of Law Digital Commons. It has been accepted for inclusion in Maine Law Review by an authorized editor of University of Maine School of Law Digital Commons. For more information, please contact [mdecrow@maine.edu](mailto:mdecrow@maine.edu).

# PROTECTIVE CLAIMS FOR REFUND: PROTECTING THE INTERESTS OF TAXPAYERS AND THE IRS

- I. INTRODUCTION
- II. HISTORICAL DEVELOPMENT OF PROTECTIVE CLAIMS FOR REFUND
  - A. *Federal Case Law*
  - B. *Internal Revenue Service Publications*
  - C. *The Existence and Application of Protective Claims for Refund in State Tax Laws*
- III. CONSTITUTIONAL CONSIDERATIONS
- IV. REQUEST FOR CONGRESSIONAL AMENDMENT TO THE INTERNAL REVENUE CODE
- V. CONCLUSION

## PROTECTIVE CLAIMS FOR REFUND: PROTECTING THE INTERESTS OF TAXPAYERS AND THE IRS

The Internal Revenue Code provides taxpayers wishing to claim a refund of an overpayment of taxes with a simple, straightforward provision setting forth a taxpayer's right to make such a claim. Additionally, regulations exist that provide for the procedure to be followed in order to claim a refund, further clarifying what is expected of the taxpayer. Unfortunately, not all situations that give rise to the right to claim a refund are so straightforward and simple. Taxpayers may find themselves in a situation that seems to have very little direct connection with tax, but may nonetheless result in significant tax consequences. Many of these situations may be unforeseen or rarely considered by the average taxpayer.

Both the Treasury Department and the courts have attempted to fashion remedies for taxpayers dealing with these unexpected situations and their resulting consequences. However, inconsistency among these various remedies has left taxpayers and tax attorneys searching for a more concrete resolution. Seeking to strike an appropriate balance between promoting administrative efficiency, achieving fair results for the taxpayer while still requiring taxpayer diligence, and implementing an effective and equitable policy is a difficult but necessary task.

### I. INTRODUCTION

Twenty-six U.S.C. § 6511(a) 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 which the tax was paid.<sup>1</sup>

In order to formally conform with the provisions of § 6511, taxpayers may file claims for refund in one of two ways: a taxpayer may claim a refund of an overpayment directly on the tax return itself for the pertinent tax year, or may file an amended return for the tax year in which the overpayment or erroneous collection occurred.<sup>2</sup> However, in an attempt to respond to various unforeseen situations and to allow for some flexibility in these rigid requirements, the Internal Revenue Service has traditionally and consistently accepted less formal claims for refund—provided they are timely and adequately explain the grounds for the claimed re-

---

1. 26 U.S.C. § 6511(a) (2000).

2. 26 C.F.R. § 301.6402-3 (2003). "A return or amended return shall constitute a claim for refund or credit if it contains a statement setting forth the amount determined as an overpayment and advising [the Internal Revenue Service] whether such amount shall be refunded to the taxpayer or shall be applied as a credit." *Id.* § 301.6402-3(5); *but see*, *United States v. Andrews*, 302 U.S. 517, 520 (1938) (finding that the taxpayer, while claiming to have filed an amendment to a claim for refund after the expiration of the statute of limitations, was in fact filing a new claim which was disallowed because the period for requesting a refund of taxes had lapsed); *Hindes v. United States*, 371 F.2d 650, 653 (5th Cir. 1967), stating:

A taxpayer is not permitted to advance one ground for refund in his claim filed with the Commissioner and thereafter rely upon an entirely different ground in a subsequent suit for refund, but [rather] is confined to the scope of the grounds for refund asserted in his claim filed with the Commissioner.

*Id.* (quoting *Carmack v. Scofield*, 201 F.2d 360, 362 (5th Cir. 1953)).

fund.<sup>3</sup> Indeed, the regulations provide that non-literal compliance with the requirements of § 6511 will not bar a taxpayer from making a claim for refund, provided that such claims set forth in detail the grounds upon which the refund is claimed, provide the factual basis for the claim, and verify that the claim is being made under the pains and penalties of perjury.<sup>4</sup>

Further flexibility is provided by allowing a valid claim for refund to be amended to reflect changes or update information up until the statute of limitations provided in § 6511 expires.<sup>5</sup> However, if the amendment is intended to make the claim more specific, it may still be made even after the statute of limitations has expired.<sup>6</sup> For tax practitioners, allowing amendments to be made subsequent to the expiration of the statute of limitations is crucial. "[I]t is not uncommon, especially when taking on new clients, to discover just before the statute runs that there may be grounds for a refund."<sup>7</sup> Working under the time constraints set forth by § 6511 can result in added pressure for a practitioner, particularly in a situation where relevant information does not surface immediately.

Amendments to a refund claim should "either clarif[y] what the [IRS] already knows or [already] should know."<sup>8</sup> Essentially, a refund claiming a nominal amount

3. "A long line of cases . . . treats letters, marginal notations on tax returns for related later years, and other informal statements as claims for a refund despite their formal inadequacies if they are timely and adequately advise the [Internal Revenue Service] of the taxpayer's demand." BORIS I. BITTKER, MARTIN J. MCMAHON, JR. & LAWRENCE A. ZELENAK, *FEDERAL INCOME TAXATION OF INDIVIDUALS*, ¶ 47.3(2) (3d ed. 2002) (footnote omitted).

4. 26 C.F.R. § 301.6402-2(b)(1) (2003). However, it is important to recognize that: The requirement of specificity is mitigated by (1) the possibility of waiver by the [Internal Revenue Service] if it proceeds to investigate the taxpayer's claim and thereby learns more about its basis and (2) the taxpayer's right to amend the claim to make it more specific, even after the statutory period for filing an original claim has expired. BORIS I. BITTKER & LAWRENCE LOKKEN, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS*, Part 16, Chapter 113, § 3 (1997 & Supp. 2002).

5. BORIS I. BITTKER, MARTIN J. MCMAHON, JR. & LAWRENCE A. ZELENAK, *FEDERAL INCOME TAXATION OF INDIVIDUALS*, ¶ 47.3[2] (3d ed. 2002).

6. *Id.* See also *Bankers Trust Co. v. United States*, 438 F.2d 1046, 1048 (2d Cir. 1971) (stating "so long as the refund action is timely, [an amendment] will be allowed even though made outside the time limitations of Sec. 6511(a)"). There has been discussion as to what extent taxpayers may take advantage of this opportunity.

In the extreme situation, "the filing of a paper which gives no notice of the amount or nature of the claim . . . and refers to no facts upon which it may be founded" is not going to be a sufficient claim. It is worth noting, however, that if that insufficient claim is amended before being rejected, there is certainly support for the proposition that the amendment is considered timely even though the original claim is defective. See *dicta* in *American National Insurance Company v. Bass*, 68 F.2d 511 (5th Cir. 1934), and the cases cited there, supporting the conclusion that, although original claims "were in themselves of inadmissible generality . . . they were yet sufficient, while still pending unrejected, to toll the running of the statute and to support amendments to them having sufficient specification."

Burgess J. W. Raby & William L. Raby, *Perfecting Imperfect Refund Claims*, 85 TAX NOTES 1173, 1174 (1999).

7. Raby, *supra* note 6, at 1174.

8. *Id.* A few examples of amendments that follow this guideline include: adding facts to the amended return that were contained in the original return that was filed, or simply providing the IRS with information that would otherwise be discovered during the normal review of a claim for refund, such as a discrepancy between the tax amount paid in connection with the original return and the tax amount claimed for refund. *Id.*

of money (such as \$1), but clearly setting forth the legal and factual grounds for relief, will be accepted and can later be amended to reflect the correct refund amount even though the statute of limitations has expired.<sup>9</sup> As a matter of administrative policy, it seems reasonable for the IRS to request that taxpayers provide as much information as possible about a claim for refund as is available at the time of filing so that it may process the claim more quickly and accurately. Often, however, many taxpayers are not as forthcoming with information as the IRS might otherwise hope, either because they do not wish to divulge unnecessary information or because the information is simply not yet available to the taxpayer. For example, taxpayers involved in litigation that does not directly involve a tax matter, like a criminal trial, but may nonetheless result in certain tax consequences, may not wish to provide the IRS with any more information regarding the litigation than is necessary.<sup>10</sup> The Internal Revenue Service and the Treasury Department have attempted to accommodate such taxpayers.

The practice of allowing amendments to refund claims subsequent to the expiration of the statute of limitations has effectively created a class of refund claims commonly referred to as protective claims for refund. "A 'protective' claim differs from an actual claim because the taxpayer does not want the [IRS] to act on the protective claim [at the time it is filed]."<sup>11</sup> Although not yet codified within the Internal Revenue Code, protective claims for refund have been developed through case law and in IRS publications.<sup>12</sup>

Currently, nowhere in the Internal Revenue Code would one find an express provision setting forth a taxpayer's right to file a protective claim nor even a provision recognizing that such claims exist. Further, no general IRS regulation has been adopted that defines what a generic protective claim for refund consists of or what conditions must exist to warrant their filing. Despite its noticeable absence from the Internal Revenue Code and IRS regulations, courts expect unrepresented taxpayers to file a type of claim for which no provision exists. There is no provision to which taxpayers can look for guidance in protecting their rights to a refund of overpaid taxes. Taxpayers opting to pursue their right to claim a refund often reach the litigation stage only to have courts determine that the statutory period for filing a claim for refund has lapsed and that the taxpayer's only recourse would have been to file a protective claim prior to the expiration of the statute of limitations. This type of situation places the ordinary taxpayer in a difficult position because courts are finding that the only option available to the taxpayer to maintain their right to a refund was to follow a procedure that does not exist in the Internal Revenue Code or in its regulations.

With no protective claim provision in the Internal Revenue Code, a taxpayer must look to other sources for guidance and definitions of such claims. Taxpayer

---

9. *Id.*

10. See *Swietlik v. United States*, 779 F.2d 1306 (7th Cir. 1985).

11. Raby, *supra* note 6, at 1174.

12. See *Sun Chem. Corp. v. United States*, 698 F.2d 1203, 1208 n.8 (Fed. Cir. 1983) (finding that "[t]here is nothing wrong with filing a conditional claim per se"); *Swietlik v. United States*, 779 F.2d at 1307 (stating that when claims are uncertain as to its mere existence or amount, filing a protective claim is an appropriate measure); Rev. Proc. 2002-52 I.R.B. 242, 2002 IRB LEXIS 325, \*38 (setting forth the requirements of a valid protective claim in connection with a request for competent authority assistance).

advocates should be skeptical of expectations placed on individual taxpayers that they be cognizant of alternative sources of information and take such affirmative steps to determine their options for maintaining their right to a refund. While secondary sources, such as case law, treatises, and IRS publications may serve as an aid in notifying a taxpayer of when a protective claim for refund is the appropriate course of action, as a matter of tax policy, one should consider whether it is both appropriate and realistic to expect that taxpayers are sufficiently made aware of the availability of protective claims for refund through these secondary sources.

These secondary research sources reveal that “[a] protective claim for refund is filed to protect a right to receive a refund contingent [upon] the occurrence of a future event. . . . [I]t may be filed on a formal claim form or it may be filed as an informal claim.”<sup>13</sup> Protective claims are filed with the intention to toll the statute of limitations “when either the law or the facts [of the case] are still in flux.”<sup>14</sup> If the amount of tax deemed to be overpaid is uncertain, or if the refund itself is contingent, filing a protective claim is appropriate.<sup>15</sup> Situations that give rise to this uncertainty and which may warrant the filing of a protective claim could include:

[I]nstances where a pending or hoped-for change in the tax law might be retroactive, a change in nontax law, or [if the] tax issue may be affected by the outcome of pending court cases—tax or non tax. There may be future transactions that will have retroactive effect. . . . [or e]conomic developments that have not yet occurred may clarify past tax situations.<sup>16</sup>

Further, “[a] protective claim may be required to protect potential refunds when a special statutory regime is involved.”<sup>17</sup> A taxpayer in one of these situations, even after consulting the existing secondary sources, will likely be left with additional questions such as: What constitutes a valid protective claim for refund? On what form should the protective claim be submitted? At what point do protective claims need to be filed?

---

13. MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE ¶ 11.08(3) (2002), available at 1999 WL 1050968. A formal claim for refund is generally filed on the return for the tax year in which the refund is being claimed. If the overpayment is discovered after the return has been filed, an amended return should be filed. *Id.* An informal claim for refund is often honored despite its failure to satisfy the regulation requirements. *Id.* For an informal claim to be considered as valid, the claim must:

(1) have [included in it] a written component, (2) that is sufficient to apprise the [Internal Revenue Service] that a refund is being claimed, and (3) that specifies the tax and the year or years for which the refund is being sought sufficiently so that the [IRS] can investigate the claim.

*Id.* ¶ 11.08(2).

14. Raby, *supra* note 6, at 1174.

15. MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE ¶ 11.08(3) (2002), available at 1999 WL 1050968. “It is not enough that the [Internal Revenue Service] has in its possession information from which it might find that the taxpayer is entitled to, or might desire, a refund.” *Martin v. United States*, 833 F.2d 655, 660 (7th Cir. 1987). Presumably this means that a taxpayer should not be allowed to file a frivolous protective claim for which there is no foundation for a refund.

16. Raby, *supra* note 6, at 1174.

17. MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE ¶ 11.08(3) (2002), available at 1999 WL 1050968. Michael Saltzman provides as an example, a tax imposed on insurance companies that, for two years after filing returns as insurance companies, fail to qualify as insurance companies and, as a result, become liable for a separate tax for the year they last qualified as insurance companies. *Id.*

Similar to traditional claims for refund, protective claims should be as complete as possible and based on the most accurate and reliable information available to the taxpayer at the time of filing.<sup>18</sup> Additionally, protective claims should be more than a simple statement of an intention to file a claim for refund in the future.<sup>19</sup> "By labeling [the claim for refund] a protective claim, the taxpayer is asking the IRS to simply hold the claim without action until the contingency either does or does not occur. Then the claim can either be perfected or withdrawn."<sup>20</sup>

As a result of the lack of clear guidance from the IRS, it comes as no surprise that protective claims have received varying treatment at the federal level and among the states.<sup>21</sup> This Comment will review the development of protective claims for refund despite the lack of any legislative action taken to adopt an amendment to the Internal Revenue Code to define if, when, and to what extent, protective claims may be filed. Included in this review will be an analysis and comparison of the role of protective claims in the history of the case law at various court levels. This Comment will explore the policy considerations suggested by various courts both for and against the use of protective claims.

Additionally, this Comment will review protective claims at the state level in both case law and state statutes and will consider the administrative policies behind adopting such a practice at the state level. A comparison will be drawn between the expectations of a taxpayer to file a protective claim for refund at the federal level and at the state level. Further, this Comment will review the constitutional concerns that have arisen in a state proceeding relating to protective claims for refund and will consider the potential for further constitutional argument if the courts and the IRS remain unwilling to define the scope of protective claims.

In its suggestion for legislative action, this Comment rejects the notion that even the most diligent of taxpayers, when unrepresented by either a Certified Public Accountant or a tax attorney, can be expected to rely on case law and obscure, often factually unrelated, Revenue Rulings to determine that filing a protective

---

18. *See id.*

19. *Id.*

20. Raby, *supra* note 6, at 1175.

21. *See, e.g.,* Sun Chem. Corp. v. United States, 698 F.2d 1203, 1208 n.8 (Fed. Cir. 1983) ("There is nothing wrong with filing a conditional claim per se"); Kellogg-Citizens Nat'l Bank v. United States, 330 F.2d 635, 639 (Ct. Cl. 1964) (holding that taxpayers are expected to make every reasonable effort possible, including the filing of a protective claim, to hold open the statute of limitations and maintain their right to a potential claim for refund); Swietlik v. United States, 779 F.2d 1306, 1307 (7th Cir. 1985) (finding that when a refund claim is uncertain as to its mere existence or to its amount, filing a protective claim is an appropriate course of action); PALA, Inc. v. United States, 234 F.3d 873, 880 (5th Cir. 2000) (noting that the taxpayer could have filed a protective claim to avoid expiration of the statute of limitations which barred the claim from being filed); Estate of Mueller v. Comm'r of Internal Revenue, 153 F.3d 302, 303 (6th Cir. 1998) (holding that the taxpayer had failed to file a protective claim and the statute of limitations had expired, and therefore the taxpayer was unable to amend its position in the Tax Court proceeding to assert the affirmative defense of equitable estoppel); *but see*, Bankers Trust Co. v. United States, 438 F.2d 1046, 1048 (2d Cir. 1971) (finding that filing a protective claim in which the amount to be claimed is currently uncertain is an inefficient method); Chertkof v. United States, 676 F.2d 984, 991 (4th Cir. 1982) (arguing that claims for refund that are unable to be filed because of pending litigation are not the types of claims that Congress intended to bar when enacting the three-year statute of limitations set forth in the provisions of 26 U.S.C. § 6511(a)).

claim is appropriate for their circumstances. This Comment will suggest that affirmative IRS and legislative action is needed at the federal level to clarify both a taxpayer's right to file and the scope of protective claims for refund by adopting an express provision in the Internal Revenue Code. Moreover, this Comment suggests that a federal protective claim provision would provide guidance to the states in formulating their own statutory and administrative regulations for protective claims at the state level. Finally, this Comment proposes that with careful drafting, the twin aims of the IRS to both encourage administrative efficiency and to promote equitable results for taxpayers, can be achieved by Congress's adoption of a protective claim provision.

## II. HISTORICAL DEVELOPMENT OF PROTECTIVE CLAIMS FOR REFUND

Though protective claims for refund are not yet provided for in the Internal Revenue Code, the courts and the IRS generally accept the existence of protective claims at the federal level. However, this has not always been the case. Although protective claims have been directly authorized by the IRS in certain, specific circumstances, there has not yet been a blanket policy adopted regarding protective claims for refund. Without an express provision in the Internal Revenue Code or an IRS Regulation, courts remain at liberty to question the existence of such claims, as well as to evaluate the administrative policy behind barring recovery for those taxpayers who fail to file protective claims prior to the expiration of the statute of limitations.

### A. Federal Case Law

The Supreme Court considered the validity of an informal protective claim filed to toll the statute of limitations in *United States v. Kales*.<sup>22</sup> In *Kales*, the IRS issued deficiency notices in March 1925, to the taxpayer stemming from an increase of profits in connection with her sale of stock in the Ford Motor Company in March 1919, and upon which she paid income taxes in 1920.<sup>23</sup> The taxpayer owned 525 shares of stock in the Ford Motor Company.<sup>24</sup> Prior to the sale, in March 1913, the taxpayer requested and received a ruling that the value of her shares was equal to \$9,489 per share.<sup>25</sup> In actuality, the taxpayer sold her shares of stock, six years later, for \$12,500 per share.<sup>26</sup> On her 1919 tax return, the taxpayer reported profit equal to the amount that exceeded the IRS's evaluation, and paid tax of over one million dollars.<sup>27</sup> The deficiency notices were issued on the grounds that the \$9,489 valuation was overstated and that the taxpayer had in fact realized additional gain in the amount of \$2,627,309.<sup>28</sup>

In the same month that the deficiency notices were issued, the taxpayer paid the assessment and filed a written protest stating that she would claim the right to a refund if the IRS's valuation of the stock, upon which the taxes were originally

---

22. *United States v. Kales*, 314 U.S. 186, 193 (1941).

23. *Id.* at 190.

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.*



calculated, was to stand.<sup>29</sup> A formal claim for refund was subsequently filed in September 1928, for the amount that the taxpayer had remitted in response to the deficiency notice.<sup>30</sup> This formal claim was purported to be an amendment to the claim filed with the written protest in 1925.<sup>31</sup> The Court opined that

[s]uch a use of the future tense in stating a claim may, with due regard to the circumstances of making it, rightly be taken as an assertion of a present right . . . [and thus,] [t]he statement that upon the happening of the contingency the claim will be prosecuted is not inconsistent with the present assertion of it.<sup>32</sup>

The holding of this frequently-cited opinion appears quite broad, suggesting that a mere statement of a taxpayer's intention to file a claim for refund upon the happening of some future event, is to be treated equally with a fully completed, formal claim for refund. As a matter of administrative policy, it seems unquestionable that the IRS would rather handle complete, formal claims for refund and would not equate them with less formal, incomplete claims. For obvious reasons, the IRS is unable to process a claim contingent upon the happening of a future event and thus, an incomplete claim that must be set aside until such event occurs, could be construed as being administratively burdensome on the IRS.

The holding in *Kales*, however, can be limited in light of the fact that this taxpayer knew of the value of the stock upon which the deficiency notices were calculated and could essentially provide the IRS with the exact amount of the overpayment should the IRS's valuation be sustained in the litigation. The only contingency that existed was whether the basis in the stock upon which Kales reported her gain from the sale of the securities was overstated.<sup>33</sup> Thus, it does not seem that the IRS would be overly burdened by claims similar to Kales's where the taxpayer fully completes the claim and the only question to be litigated is whether a claim for refund will be honored.

A case that likely caused more administrative difficulty than *Kales* was heard by the Court of Claims in 1964. In *Kellogg-Citizens National Bank v. United States*,<sup>34</sup> the plaintiff, as executor of the estate of Joseph B. Holzer, filed an estate tax return in April 1955, and paid estate tax of over \$26,000 immediately thereafter.<sup>35</sup> Approximately two years later, in 1957, the IRS issued deficiency notices stemming from unpaid income tax and penalties totaling over \$111,000 incurred by the decedent prior to death for tax years 1945 through 1953.<sup>36</sup>

After petitioning the Tax Court to set aside the deficiency notices, but prior to the court hearing the merits of the case, the parties reached a settlement in April

---

29. *Id.* at 190-91.

30. *Id.* at 191. In addition to claiming a refund of payment of the deficiency notice, the taxpayer also requested a refund of a portion of the original income tax paid on the sale of the securities. The taxpayer based her claim for refund of the additional taxes on the ground that the Board of Tax Appeals, in a separate decision, had determined that the value of the same stock for a different taxpayer as of March 1913, was \$10,000 per share, and she argued that she too should have the benefit of this higher basis. *Id.*

31. *Id.*

32. *Id.* at 196.

33. *Id.* at 190-91.

34. 330 F.2d 635 (Ct. Cl. 1964).

35. *Id.* at 636.

36. *Id.*

1960, and income tax was paid by the estate two months later.<sup>37</sup> Within a month after the settlement, the plaintiff filed an amended estate tax return and claimed a refund of estate taxes of nearly \$18,000.<sup>38</sup> This claim for refund was subsequently amended in April 1961, raising the refund request to over \$24,000.<sup>39</sup> Both of these claims for refund were denied by the IRS in September 1961, as having been filed beyond the expiration of the statute of limitations.<sup>40</sup>

In a motion for summary judgment, the United States argued that a refund claim stemming from an estate tax return originally filed in April 1955, would have to have been filed by April 1958, to be considered timely, but that in this case, the first request for refund was not made until June 1960.<sup>41</sup> The counterargument by Kellogg-Citizens Bank was that it was unaware, up until the settlement accepted by the Tax Court in 1960, of the amount owed in additional income taxes, and of how much of a deduction could be claimed on the estate tax returns.<sup>42</sup> Kellogg-Citizens Bank argued that the 1960 settlement determination did not occur until two years after the statutory limitation period would otherwise have expired.<sup>43</sup> Further, the taxpayer argued that in light of this type of situation, the three-year limitation period must have begun in 1960, when the determination was made by the Tax Court, instead of 1955, when the original estate tax return was filed.<sup>44</sup> Essentially, the taxpayer argued that if the three-year limitation period began in 1955, the period for filing a claim for refund would have expired before it was even known that a refund was available or in what amount the tax was overpaid.<sup>45</sup>

The Court of Claims, in issuing its decision, found it significant, "that the [taxpayer] knew, some ten months before the expiration of the three years within which it could file a normal refund claim on the estate tax, that the Internal Rev-

---

37. *Id.* at 636-37. Under the terms of the settlement agreement, it was agreed that there were no deficiencies of income tax pertaining to tax years 1945 through 1947, but that the decedent had a remaining tax obligation for tax years 1948 through 1953, totaling \$41,685.37, including penalties. *Id.* at 637.

38. *Id.* at 637.

39. *Id.* The claims for refund were based on recalculation of the estate tax to allow the additional income tax, interest and penalties as deductions on the amended estate tax return thereby resulting in an overpayment of estate tax as originally filed in April 1954. *Id.*

40. *Id.*

41. *Id.* The United States based its motion for summary judgment both on the provisions of 26 U.S.C. § 6511(a), *see supra* note 1 and accompanying text, as well as on the limitations imposed on filing suit which are provided in § 7422 as follows:

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

26 U.S.C. § 7422(a) (2000).

Accordingly, the United States sought a dismissal arguing that no claim for refund had been duly filed, thus barring Kellogg-Citizens Bank from being able to file suit. Kellogg-Citizens Nat'l Bank v. United States, 330 F.2d 635, 637 n.2 (Ct. Cl. 1964).

42. *Id.* at 637.

43. *Id.*

44. *Id.*

45. *Id.*

enue Service was demanding extra tax and penalties on account of the decedent's income tax liability before his death."<sup>46</sup> The court went on to reason that since the deficiency notices would likely result in additional deductions for purposes of the estate tax if they were upheld, "the estate ha[s] the opportunity to protect itself by filing, within the remaining ten months, a protective claim for refund . . . [and] nothing prevented the estate from doing the best it could, *i.e.*, filing a protective refund claim based on the deficiency notices it had received."<sup>47</sup> In so holding, the court set a standard for claims that are at risk of violating § 6511 by stating, "to avert the bar of limitations, [a plaintiff should go] as far as it reasonably [can] to protect its potential right to a refund."<sup>48</sup>

---

46. *Id.* at 638. Compare *Amoco Production Co. v. Newton Sheep Co.*, 85 F.3d 1464, 1466 (10th Cir. 1996) (holding that although taxpayers would not know exactly what portion of the royalties they would be entitled to, "they could have sought refunds of the taxes under the assumption that they would ultimately prevail in the title dispute. Taking such action would have preserved their tax refund claims until the final resolution of the title dispute.") *Id.* at 1471. In so holding, the Tenth Circuit qualified the opinion in *Kellogg-Citizens Bank* that individuals seeking a refund of taxes are obligated to go as far as possible to protect the right to a refund by stating that "[t]his was not a situation in which the taxpayers had no knowledge that they would potentially have a refund claim." *Id.*

The facts in *Amoco* arose out of an action to quiet title to petroleum found on land in Utah. *Id.* at 1466. There was disagreement between the plaintiff and the party to the quiet title action with regard to an accounting that was done for the proceeds received from the oil and gas that Amoco had purchased from the production of the leased land during the title dispute. *Id.* The oil and gas proceeds would normally have been paid by Amoco to the defendants of the action were it not for Amoco bringing the action to quiet title. *Id.* at 1467. The court ordered all proceeds retained during the title litigation to be paid to an escrow account and remain there until the litigation concluded. *Id.*

During the title litigation, although it was later repealed, Congress enacted the Windfall Profit Tax on domestic crude oil which Amoco remitted to the escrow account on behalf of the defendants to the quiet title action. *Id.* Under the terms of the Windfall Tax statute, the return that required filing with respect to this particular tax was the income tax return of the person who was liable to remit the windfall tax payment. *Id.* at 1470. "Accordingly, for the purpose of applying the three-year rule of section 6511(a), the starting point for the running of the statute of limitation for each [party to the quiet title action] was the due date of his or her individual income tax returns for 1980 through 1986." *Id.* at 1470-71.

Upon conclusion of the action to quiet title, the defendants filed claims for refund of the windfall taxes withheld arguing that Amoco was not required to remit those taxes during the title dispute. *Id.* at 1467. The Tenth Circuit based their holding on an IRS announcement pertaining specifically to protective claims of windfall taxes. *Id.* at 1471 (citing I.R.S. Announcement 83-39, 1983-10 I.R.B. 29, available at 1983 WL 188098). This revenue announcement was issued because litigation concerning the constitutionality of the windfall tax was pending and the IRS recommended that taxpayers file a protective claim for refund so as to avoid the bar of the statute of limitations pending the outcome of the litigation. *Id.*

47. *Kellogg-Citizens Nat'l Bank v. United States*, 330 F.2d 635, 638-39 (Ct. Cl. 1964). The court recognized, however, that the estate could not be certain of the amount of income tax to be paid resulting from the deficiency notice. *Id.* at 638. However, the court reconciled this with the notion that the estate should have presumed the amount listed to be correct and filed a protective claim based upon that amount. *Id.* at 638-39.

48. *Id.* at 639. The Court of Claims initially deferred disposition of this case pending the decision by the Supreme Court in *United States v. Zacks*, 375 U.S. 59 (1963). *Kellogg-Citizens Nat'l Bank v. United States*, 330 F.2d at 637. The court stated that "[a]lthough Zacks is quite a different case, our view is that the opinion of the Supreme Court reflects [its] basic attitudes which should guide us in dealing with the present problem." *Id.* In *Zacks*, the taxpayer had received royalties from the grant of an exclusive license of patent rights to a manufacturing

The current tax system is one that depends on taxpayers to be forthcoming, as they are expected to self-report their tax liability under the pains and penalties of perjury. It would stand to reason, therefore, that taxpayers might also be expected to be aware of potential changes and any possible overpayments to which they may be entitled. Thus, expecting taxpayers to do everything in their power to protect their right to a refund is not inconsistent with the self-reporting system that requires taxpayers to diligently and accurately report their tax liability.

While it may seem unusual that a taxpayer, at risk of losing a substantial sum of money, would not be making every effort possible to recover that money, it is also unreasonable to expect that unsophisticated taxpayers will be able to avail themselves of the remedy of filing a protective claim when no provision in the Internal Revenue Code exists to establish this right. Certainly one of the strongest arguments against a requirement that taxpayers file protective claims for refund is that the process is cumbersome to both the taxpayer and the IRS. Serious consideration should be given as to whether asking taxpayers to prepare and file a claim for refund that is incomplete, cannot be processed, and may eventually be withdrawn, is advantageous to either party, or whether it is simply unnecessary paperwork. As one might expect, such an argument has not gone without consideration by the courts.

The Second Circuit questioned the practicality of protective claims in *Bankers Trust Company v. United States*.<sup>49</sup> There, the IRS disallowed certain charitable deductions that were taken on the decedent's estate tax return and issued a deficiency assessment as a result.<sup>50</sup> The deficiency assessment and notice of disallowance of the deduction were not received until nearly four years after the estate tax was initially paid.<sup>51</sup> The deficiency notice was subsequently paid and a claim for refund was filed with the Internal Revenue Service.<sup>52</sup>

---

corporation. *United States v. Zacks*, 375 U.S. at 60. Under the laws at that time, the taxpayer reported the royalties as ordinary income on her income tax return filed in 1953. An amendment was passed to the Internal Revenue Code in 1956, the same year that the taxpayer's right to claim a refund had expired, providing that royalties like those received by the taxpayer should be reported as capital gains instead of ordinary income. *Id.* The taxpayer filed a claim for refund based upon the 1956 amendment and commenced a refund suit in the Court of Claims. *Id.* at 60-61.

The Court of Claims granted a motion in favor of the taxpayers to strike the government's defense that the suit was barred by 26 U.S.C. § 7422(a) and entered judgment in favor of the taxpayer. *Id.* at 61. The Supreme Court granted certiorari and reversed the decision of the Court of Claims. *Id.* Looking to the legislative history of the amendment, Justice Harlan's majority opinion held that although the amendment was enacted retroactively, "Congress [did not intend] to reopen for retroactive adjustment tax years with respect to which refund claims were already barred by limitations. [The amendment] does not in terms waive the application of the statute of limitations to refund claims then finally barred." *Id.* at 64. The *Kellogg-Citizens Bank* Court stated that the holding in *Zacks* "neutralized that part of the general theory of our earlier opinions . . . which may have seemed to suggest the extension of the statute of limitations whenever an event reducing a taxpayer's liability occurred after the payment of the tax or the filing of the return." *Kellogg-Citizens Nat'l Bank v. United States*, 330 F.2d at 638.

49. *Bankers Trust Co. v. United States*, 438 F.2d 1046 (2d Cir. 1971).

50. *Id.* at 1047.

51. *Id.*

52. *Id.*

When no action was taken on the refund claim, the taxpayers initiated litigation in the district court.<sup>53</sup> The estate filed a second claim for refund by amending the estate tax return to reflect a deduction for attorneys' fees.<sup>54</sup> The government argued that an estate, in this situation, should file a protective claim for refund for attorneys' fees upon receipt of the deficiency assessment.<sup>55</sup> The court held that "to require the filing of such a protective claim at a time when the future necessity for incurring attorneys' fees is speculative and the amount unknown, would call for a useless act that would serve no legitimate purpose of either the Government or the estate."<sup>56</sup>

The Second Circuit was not alone in expressing its concern about the policy behind protective claims. Ten years after the decision in *Bankers Trust*, the Fourth Circuit also questioned the practicality of filing protective claims for refund. In *Chertkof v. United States*,<sup>57</sup> the Fourth Circuit appeared wary of imposing a duty to file a protective claim on taxpayers who are involved in litigation if such litigation will be the determining factor in deciding if, and in what amount, a claim for refund may arise.

The dispute in *Chertkof* centered on the basis valuation of certain shares of stock that were transferred into a trust upon the death of the stockholder.<sup>58</sup> The IRS did not accept the estate tax valuation of the stock's basis as determined by the executors of the estate and subsequently issued deficiency notices imposing tax based upon their own valuation of the stock.<sup>59</sup> The matter was not settled in a timely manner at the administrative level and litigation ensued with the taxpayers in the United States Tax Court.<sup>60</sup>

The litigation commenced in November 1974, when the Tax Court entered a decision stemming from an out-of-court settlement between the parties.<sup>61</sup> The settlement resulted in an increase in estate tax liability for the taxpayer's estate.<sup>62</sup> However, in calculating the tax on the income from the sales and liquidating distributions of the securities held in the trust for the years prior to receiving the deficiency notices, the taxpayer's estate had used the valuations of the stock as listed on the original estate tax return.<sup>63</sup> As such, the resulting settlement meant that the

---

53. *Id.* In its decision almost four years after the claim for refund was filed, the district court held that "the charitable deductions were improperly disallowed by the Commissioner and granted the refund [to the taxpayer]." *Id.*

54. *Id.* The court here notes that claiming a refund of attorneys' fees is not subject to the statute of limitations in § 6511(a). *Id.* The court remarked that, "Such a claim need not be set forth in the refund claim but may be asserted for the first time in the complaint prosecuting the claim for refund, and the complaint may be amended to reflect a request for attorneys' fees any time prior to the entry of judgment." *Id.* at 1047-48 (citing Treas. Reg. § 20.2053-3 (1954)).

55. *Id.* at 1048.

56. *Id.*

57. *Chertkof v. United States*, 676 F.2d 984 (4th Cir. 1982).

58. *Id.* at 985. Upon the death of a stockholder where stocks owned by the decedent are transferred to another individual or a trust, "the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall . . . be . . . the fair market value of the property at the date of the decedent's death. . . ." 26 U.S.C. § 1014(a) (2000).

59. *Chertkof v. United States*, 676 F.2d at 985.

60. *Id.*

61. *Id.* at 985-86.

62. *Id.* at 986.

63. *Id.*

estate had overstated its gains and understated its losses when reporting its income tax during those years.<sup>64</sup>

The Fourth Circuit held that the Tax Court's determination of the stock valuation for estate tax purposes was also an essential income tax consideration for the year at issue.<sup>65</sup> The court rejected the government's argument that mitigation of the statute of limitations should not occur because the adjustments sought by the taxpayer were of income tax and the decision upon which the refund was claimed was a judicial determination regarding estate tax liability.<sup>66</sup> In holding that the government's argument was "unrealistically narrow," Judge Murnaghan stated that "[although] the Tax Court's . . . determinations are for estate tax purposes, nevertheless, they are closely related to, or made respecting, an essential income tax consideration."<sup>67</sup> The Fourth Circuit therefore found that:

The situation in which the taxpayers here find themselves appears to provide a classic example of the sort of nonculpable trap into which one is all too likely to fall . . . whenever there is disagreement as to liability, valuation or amount, [and which] causes the limitations period for claiming a refund of one tax obligation to expire prior to the date on which a determination takes place with respect to another tax liability.<sup>68</sup>

---

64. *Id.*

65. *Id.* at 987.

66. *Id.* The taxpayers in this case were seeking relief under the mitigation provisions which are provided for in sections 1311-1314 of the Internal Revenue Code. Section 1311 provides in relevant part:

(a) General Rule

If a determination . . . is described in one or more of the paragraphs of section 1312 and, on the date of the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law or rule of law . . . then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314.

(b) Conditions Necessary for Adjustment

(1) [A]n adjustment shall be made under this part only if—

(A) in the case the amount of the adjustment would be credited or refunded in the same manner as an overpayment under section 1314, there is adopted in the determination a position maintained by the Secretary . . . or

(B) in the case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under section 1314, there is adopted in the determination a position maintained by the taxpayer with respect to whom the determination is made, and the position maintained by the Secretary in the case described in subparagraph (A) or maintained by the taxpayer in the case described in subparagraph (B) is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be.

26 U.S.C. § 1311(a)-(b) (2002). Section 1312 provides for the circumstances under which the adjustment described in § 1311 is authorized. These circumstances include: (1) double inclusion of an item of gross income; (2) double allowance of a deduction or credit; (3) double exclusion of an item of gross income; (4) double disallowance of a deduction or credit; (5) correlative deductions and inclusions for trusts or estates and legatees; (6) correlative deductions and credits for certain related corporations; and (7) basis of property after erroneous treatment of a prior transaction. *Id.* § 1312.

67. *Chertkof v. United States*, 676 F.2d at 987.

68. *Id.* at 990.

The court contrasted the situation in which a taxpayer cannot know if, or in what amount, a claim for refund will be available because of pending litigation, with the situation involving a taxpayer who simply allows the period for refund to lapse, even though he is "unhampered and unhindered" from filing the claim.<sup>69</sup> In the later situation, said Judge Murnaghan, "the probabilities become strong that unfairness to [the taxpayer's] potential opponent will develop either through disappearance of evidence, weakening of memory, death or departure of witnesses, or change of position."<sup>70</sup> In writing the opinion for the court, Judge Murnaghan sided with the taxpayers in their argument that the claim for refund did not mature until the Tax Court entered its decision on the valuation of the stock.<sup>71</sup> According to the court, there was no legitimate basis for the taxpayers to file a claim for refund of income taxes for the years prior to the 1974 estate tax valuation: "[The taxpayer] did not know whether, indeed, they had a claim or, if they did, how much it amounted to."<sup>72</sup> Further, the court said that Congress did not intend to increase unessential paperwork by obligating "hypercautious taxpayers . . . to file protective claims against other possible, but as yet unascertainable, tax liabilities."<sup>73</sup>

In *Chertkof*, the Fourth Circuit recognized that a difference exists at an administrative level between a taxpayer who is asserting his right to a refund and engaged in litigation of that issue, and one who simply takes a passive stance and allows the statute of limitations to expire. But recognizing such a distinction does not address the issue of how protective claims should be handled on the whole and involves somewhat circular reasoning. If a taxpayer is litigating an issue regarding a refund in court, he is quite obviously in active pursuit of his right and a valid argument can be made that filing a protective claim is therefore unnecessary. In this situation, the court has the opportunity to declare that filing a protective claim is excessive in any case that comes before it involving refund litigation. The *Chertkof* court contrasts this situation with the passive taxpayer who simply allows the statute of limitations to expire without aggressively pursuing his right to

---

69. *Id.* at 991. But see *Murphy v. United States*, No. 95-2006, 1996 U.S. App. LEXIS 1176 (4th Cir. Jan. 30, 1996). In this unpublished decision, the court explains that the taxpayer received taxable income for tax years 1986-1988 in the form of a military survivor's pension. *Id.* at \*1. In 1991, the Board of Veteran's Appeals awarded the taxpayer tax-exempt benefits retroactively in lieu of the pension. *Id.* The taxpayer argued that application of the statute of limitations in § 6511(a) amounted to a denial of due process. *Id.* at \*2. The Fourth Circuit, stated "[s]tatutory limitations on filing claims for refund are an essential element of tax policy and do not constitute a denial of due process." *Id.* at \*3. Further, the court opined, the taxpayer could have avoided the time bar "by filing a protective claim asserting that in the event she was awarded tax-exempt veterans benefits in lieu of a taxable pension, she would claim a refund for taxes paid." *Id.* at \*3-4. This opinion begs the question as to whether sound tax policy is actually furthered by a requirement that taxpayers be required to file protective claims in anticipation of any and all possible claims for refund no matter how remote or unlikely they may be.

70. *Chertkof v. United States*, 676 F.2d at 991.

71. *Id.*

72. *Id.*

73. *Id.* However, others argue that protective claims are a legitimate means of conserving administrative resources in that filing a protective claim puts the IRS on notice that a refund claim is forthcoming, but that no immediate action should be taken. Raby, *supra* note 6, at 1174. "Having the [Internal Revenue] Service reject the protective claim would be counterproductive, inasmuch as that disallowance would then start the two-year statute for bringing suit on the claim. In most situations involving protective claims, such a suit would be a waste of resources for both the taxpayer and the government." *Id.* at 1174-75.

a refund, thereby implying that the passive taxpayer should be required to file a protective claim for refund.<sup>74</sup>

The faulty logic in this is evident when one recognizes that a taxpayer generally files a protective claim to toll the statute of limitations because they are actively litigating or pursuing the issue. This begs the question then, when would a passive taxpayer ever file a protective claim for refund? It seems that a likely answer is that a passive taxpayer might file a protective claim in one of three circumstances. The first situation involves a taxpayer who foresees a retroactive change in the tax law that could affect his tax liability. However, this situation, too, suggests that if a taxpayer recognizes that a potential opportunity may arise which will entitle him to a refund then this taxpayer is displaying the type of diligence that our tax system encourages, even though he is not yet actively pursuing the refund.

Second, if a taxpayer is following litigation involving factually similar circumstances although he is not a party to such litigation, he may file a protective claim to toll the statute of limitations and then pursue the refund claim depending upon the outcome of the proceeding. Similar to the first situation, this type of action also involves a certain degree of taxpayer diligence in following litigation that could potentially have an effect on the taxpayer's tax liability. There is an argument that this situation more closely resembles that of the passive taxpayer suggested by the Fourth Circuit because this taxpayer is simply allowing another party to actively pursue the refund and then reaping the benefits after the litigation has concluded. In essence, this puts the taxpayer in a very favorable situation where, if the taxpayer involved in litigation is unsuccessful, the passive taxpayer has lost nothing; but if the taxpayer prevails in the litigation, the passive taxpayer now has a sound basis upon which to pursue a claim for refund.

Finally, a third situation involves a taxpayer who may be simply filing frivolous claims for refund with no legal or factual basis to back up those claims. While there are certainly always individuals who will attempt to perpetrate fraud on the tax system, it seems unlikely that the concerns raised by this type of situation are vast enough to warrant disposing of the idea of protective claims for refund as a whole. Thus it seems that adopting a system that requires taxpayers to file protective claims serves the interests of both the administrative body processing the claim and the taxpayer as well.

Certainly, the abstract nature of a protective claim, and the increased paperwork that it causes, is a valid argument to be made against requiring taxpayers to so file. In an era of tough economic times, tax cuts and an increasing deficit, the thought of spending additional taxpayer money to pay IRS employees to process and file incomplete claims for refund may seem disheartening. However, filing protective claims, though they may be factually incomplete, provides the IRS with notice that the taxpayer is actively pursuing his right to claim a refund of tax.

In a situation like *Bankers Trust*, where a taxpayer is aggressively litigating his right to a refund, filing an incomplete protective claim can be viewed as unnecessary. The more apparent concern arises with taxpayers who are passively waiting for a refund opportunity to present itself. These are the taxpayers that the IRS is not aware of as potential claimants, and it is in this situation where a protective claim for refund is most warranted.

---

74. *Chertkof v. United States*, 676 F.2d at 990-91.



Ultimately, the issue can be reduced to a question of administrative policy: should the IRS adopt a formal policy of requiring taxpayers to consistently file protective claims whenever the statute of limitations is due to expire and the claim for refund has not fully matured despite the fact that doing so will necessarily result in increased, superfluous paperwork? Or, should the IRS avoid the needless paperwork and be forced to deal with inadequate notice of a taxpayer's intention to file a claim for refund and continue litigation about the timeliness of a taxpayer's refund claim?

In *Swietlik v. United States*,<sup>75</sup> the Seventh Circuit appeared to consider filing a protective claim for refund as standard procedure.<sup>76</sup> Relying on a footnote from a separate Seventh Circuit opinion,<sup>77</sup> Judge Posner stated, "[i]f a claim for refund is contingent or uncertain in amount . . . the proper procedure is to file a conditional claim before the statute of limitations runs out; if you fail to do that the statute of limitations will bar the refund."<sup>78</sup> Posner rationalized this procedural requirement by arguing, "why would Congress, in giving a taxpayer two or three years to file a claim, at the same time erect an obstacle to suit impossible to overcome even by someone who exercises the very highest degree of diligence in prosecuting his claim and is prevented from meeting the statutory deadline."<sup>79</sup> The central theme at issue in this case, according to the court, was whether a protective claim could have been filed before the litigation involving the estate tax had concluded.<sup>80</sup>

---

75. 779 F.2d 1306 (7th Cir. 1985). This case serves as an excellent example of the type of situation where an individual may be involved in litigation having little or nothing to do with tax, but where the outcome of this litigation directly impacts the tax consequences to the litigant. This case involved Bernard Safran who was accused of killing his mother, Helen, in 1977 and who plead no contest to the charge of reckless homicide. *Id.* at 1306. First Wisconsin was appointed as personal representative of Helen's estate. *Id.* Helen had left much of her considerable estate to her son, Bernard. *Id.* Several of the decedent's relatives challenged the will, arguing that, under the common law of Wisconsin, an individual who deliberately kills an heir is unable to collect inheritance from the victim. *Id.* at 1306-07. While the litigation ensued over the issue of whether Bernard had indeed intentionally killed his mother with "sufficient deliberateness to be barred by the murdering-heir rule," an estate tax return was filed and over \$400,000 in estate tax was paid. *Id.* at 1307.

In 1978, the Wisconsin trial court determined that Bernard's plea of no contest disqualified him from inheriting the estate. *Id.* at 1310. The Supreme Court of Wisconsin, on appeal, held that reckless homicide was not per se disqualifying and the case was remanded to the trial court for determination of whether Bernard had intentionally killed his mother. *Id.* at 1306. However, the following year, a settlement was reached and Bernard was only entitled to a small portion of the inheritance and the relatives who challenged the will were awarded attorney's fees. *Id.* The claim for refund at issue was filed on the basis that the attorney's fees were deductible from the estate tax. *Id.*

76. *Id.* at 1306.

77. *O'Brien v. United States*, 766 F.2d 1038, 1041, n.3 (7th Cir. 1985) (stating that "[t]he government suggests that the taxpayer could have avoided his predicament by filing either a protective claim for refund or a request for an extension of the statute of limitations for refund claims").

78. *Swietlik v. United States*, 779 F.2d at 1307.

79. *Id.* at 1308.

80. *Id.* at 1307. The opinion reveals that the plaintiff tried to argue that the previous executor of the estate was legally incapacitated and thus unable to file a protective claim for refund of estate tax. *Id.* at 1308. The estate tax refund resulted from a deduction of the attorney's fees that were awarded to the heirs who objected to the decedent's son inheriting the portion of the estate

Posner's interpretation that Congress must have intended there to be some remedy for the diligent taxpayer who finds himself encroaching on the expiration of the statute of limitations and yet not knowing for certain whether he is entitled to a refund is not necessarily in contradiction to that of Judge Murnaghen's conclusion in *Chertkof* that Congress could not have intended that the extraneous paperwork of a protective claim be filed.<sup>81</sup> The two different views of Congressional intent can be reconciled by the notion that simply because Congress intended there to be a remedy for a taxpayer involved in litigation to determine the validity of a refund at the time the statute of limitations expires, does not require that the remedy is that of filing a protective claim.

### *B. Internal Revenue Service Publications*

Despite the conflicting treatment in and among the circuits on the issue of if and when protective claims for refund are expected from a taxpayer, the IRS and the Treasury Department have issued regulations, revenue rulings and procedures relating to the appropriateness of filing protective claims in particular circumstances.<sup>82</sup> These publications give rise to the presumption that the IRS is fully cognizant of the utility and necessity of filing protective claims as a means to both protect a taxpayer's right to claim a refund and to provide adequate notice to the IRS. However, the sporadic use of protective claims at the direction of IRS publications without an actual provision in the Internal Revenue Code may still leave taxpayers and the courts unsure of their applicability.

IRS Revenue Ruling 83-15<sup>83</sup> requires a protective claim be filed in conjunction with claims for credit available under section 2013 of the Internal Revenue Code.<sup>84</sup> The Revenue Ruling states:

---

that was willed to him. *Id.* at 1307. Swietlik claimed that if the previous executor, as a fiduciary of the heirs of the estate, filed a protective claim for refund of estate taxes in anticipation of an award of attorney's fees to the objectors, he would be violating his fiduciary duty to the decedent's son. *Id.* at 1308. The court dismissed this argument on the grounds that the executor of the estate knew that there was a high probability that the will objection would end up in a decision that was adverse to the decedent's son. *Id.* at 1309.

81. *Chertkof v. United States*, 676 F.2d 984, 991 (4th Cir. 1983). See *supra* note 57 and accompanying text.

82. See, for example, Exported Taxable Substances; Protective Claims for Refund of Tax Paid Under Section 4661, 58 Fed. Reg. 31,437 (June 2, 1993) which provides "information on filing protective claims for refund of tax paid under section 4661 of the Internal Revenue Code with respect to taxable chemicals used as materials in the manufacture of a substance that was exported. It applies to substances for which a determination under Notice 89-61 is pending." *Id.* The regulation further directs the taxpayer to label a traditional refund form as a protective refund claim in order to alert the IRS of the nature of the claim. *Id.* See also, Rev. Rul. 83-79, 1983-1 C.B. 346, available at 1983 IRB LEXIS 435. In this ruling, the IRS was asked whether "an employer's timely filed protective claim for credit or refund for Federal Insurance Contributions Act (FICA) tax [will] also protect its employees' individual claims filed after the period of limitations [has] expired." 1983 IRB LEXIS 435, at \*1. The IRS held that filing a protective claim pursuant to Revenue Procedure 81-69, "does not pertain to claims for refunds of overpaid FICA tax that are made by the employees themselves. [But i]n this case[,] the employer filed the initial protective claim on behalf of all employees . . . [t]herefore, the employer's protective claim protects the interests of both the employer and all the employees." *Id.* at \*3-4.

83. Rev. Rul. 83-15, 1983-1 C.B. 224, available at 1983 IRB LEXIS 411, at \*2.

84. *Id.* at \*3-4. "Section 2013 of the Code provides, in general, that the estate of a decedent is allowed a credit for the estate tax paid on property transferred to the decedent from a transferor who died within ten years before, or within two years after the decedent's death." *Id.*

Section 6511 of the Code provides that a claim for credit or refund of an overpayment of any tax must be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever period expires later. To safeguard the right or potential right to receive a refund after each installment is paid, the executor of D's estate must file a protective claim for refund for the entire amount of credit potentially due within the time provided by section 6511. A present assertion of a claim for refund will be sufficient even though no present right to the refund has arisen at the time the protective claim is filed. The initial protective claim must be perfected by filing a subsequent claim for refund for the additional credit allowable upon the payment of each installment of the estate tax of the transferor estate, using Form 843.<sup>85</sup>

The broad language of this Revenue Ruling has the potential to cause significant administrative difficulties if Congress were to adopt such language as a protective claims provision. One can envision a situation where a taxpayer could take advantage of the theory that a present assertion of a right is the equivalent of actually holding an interest in that right. Under this language, taxpayers could claim a right to a refund of taxes with no legal basis for doing so, and then fall back on the argument that their right simply did not materialize and thus withdraw their request for refund.

By contrast, IRS Revenue Procedure 2002-52<sup>86</sup> was issued for the purpose of explaining how a taxpayer may obtain competent authority assistance from the government under certain circumstances, and provides in part for a significantly limited right to file a protective claim.<sup>87</sup> Section 9 of the IRS's Procedure deals with protective measures that are available to a taxpayer.<sup>88</sup> In setting forth the provisions for a valid protective claim, the Procedure provides that any protective claim that is filed with the IRS must adequately satisfy the following conditions to be considered a valid protective claim:

[The] protective claim must (a) fully advise the [Internal Revenue] Service of the grounds on which credit or refund is claimed; (b) contain sufficient facts to apprise the [Internal Revenue] Service of the exact basis of the claim; (c) state the year for which the claim is being made; (d) be on the proper form; and (e) be verified by a written declaration made under penalties of perjury.<sup>89</sup>

The specification for filing the protective claim required in this Revenue Procedure appears at odds with the language in Revenue Ruling 83-15 above. In this instance, the IRS is limiting the grounds upon which protective claims may be filed, allowing only those taxpayers who have sufficient legal and factual grounds to claim a refund. This language essentially makes a protective claim indistinguishable from a traditional claim for refund except that the IRS will hold off on either granting or denying the claim.<sup>90</sup>

---

85. *Id.*

86. Rev. Proc. 2002-52, 2002-31 I.R.B. 242 available at 2002 IRB LEXIS 325.

87. *Id.* at \*4-5.

88. *Id.* at \*38.

89. *Id.* at \*40.

90. Compare 26 C.F.R. § 301.6402-2(b)(1) (2002) (requiring that claims for refund set forth in detail the grounds upon which the refund or credit is made, provide the factual basis for the claim, and verify that the claim is being made under the pains and penalties of perjury). See *supra* note 2 and accompanying text.

Adopting a procedure similar to that described in Revenue Procedure 2002-52 as a general provision in the Internal Revenue Code establishing a taxpayer's right to file a protective claim for refund would benefit both the IRS and taxpayers in general. Being a similar procedure to that required for a traditional refund claim, taxpayers will be familiar with the process and have an adequate understanding of the requirements. Additionally, requiring a thorough explanation of the factual and legal basis for filing the protective claim will aid the IRS in eliminating frivolous or meritless claims. Finally, utilizing a standard form will aid in processing the claims at the administrative level and guide unrepresented taxpayers in filing a valid protective claim for refund.

An IRS Field Service Advice memo was issued in a situation involving a husband and wife who had filed gift tax returns for gifts made to the family trust, although no gift taxes were actually due from either taxpayer.<sup>91</sup> Without any knowledge that the returns had been filed, the husband's estate and the guardian for the widow also filed gift tax returns and the estate paid the amount due thereon.<sup>92</sup> The guardian brought suit claiming that the gift taxes should have been paid by the trust.<sup>93</sup> The estate filed a protective claim for refund in the event that the state court litigation resulted in a holding that the estate was not required to pay the gift tax.<sup>94</sup>

When the IRS advised the estate that no gift tax was due, the estate filed a claim seeking refund of the taxes it had paid.<sup>95</sup> This refund was filed two days beyond the expiration of the statute of limitations.<sup>96</sup> The primary concern in this situation was that the protective claim that was originally filed was based on an entirely different theory than that which resulted in the overpayment of the gift tax.<sup>97</sup> The Field Service Advice memo noted that informal claims for refund have long been recognized as valid, and that, as long as the informal claim "furnishes sufficient information to allow the [Internal Revenue] Service to make a reasonable and intelligent investigation and evaluation of the taxpayer's claim," the claim is adequate.<sup>98</sup> The memo further determined that the protective claim, even though

---

91. I.R.S. Field Service Advice, 199916003, Doc 1999-14773, 199 TNT 79-71.

92. *Id.* at \*2. A guardian was appointed because the widow was deemed incapacitated.

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* The protective claim that was filed stated that the reason for so filing was because litigation was ensuing between the estate of the husband and the wife's legal guardian. The protective claim was filed by the husband's estate and claimed a refund for the taxes paid by both the husband's estate and the wife's guardian. *Id.* The issue for the IRS was whether the husband's estate could file a claim for refund of taxes paid by the wife's guardian in light of the well-established principle that "a person may not file a claim for refund unless they are the taxpayer who was assessed with the tax deficiency." *Id.* (citing *United States v. Williams*, 514 U.S. 527 (1995)).

98. I.R.S. Field Service Advice, 199916003, Doc 1999-14773, 199 TNT 79-71 (citing *New England Elec. Sys. v. United States*, 32 Fed. Cl. 636, 641 (1995) (informal claims constitute a valid claim for refund and serve to toll the statute of limitations); *United States v. Commercial Nat'l Bank of Peoria*, 874 F.2d 1165, 1171 (7th Cir. 1989) (an informal refund claim must contain a written component and adequately notify the IRS that a refund for specified tax years is being sought); and *Am. Nat'l Bank & Trust Co. v. United States*, 594 F.2d 1141, 1143 n.1 (7th Cir. 1979) (specific legal formulations of the claims are not required on an informal claim for refund)).

filed on a different legal theory, served to hold open the statute of limitations because "it provided the [Internal Revenue] Service with sufficient notice that a refund was sought for a certain tax year, which tolls the limitation period for the filing of a proper claim."<sup>99</sup> Thus, the refund claim filed by the estate, though technically filed two days late, was deemed a timely request for refund.<sup>100</sup>

This ruling implies that despite its many assertions that informal, protective claims for refund should be completed in the same manner as a traditional, formal claim in truth, the IRS need only be informed of the tax year in which a refund may potentially arise to hold open the statute of limitations. Such an implication could result in administrative overload by taxpayers filing meritless protective claims that only state the tax year in which a refund may arise, but having no legal basis for filing such a claim. This kind of administrative policy could result in taxpayers gambling with the IRS in the hope that some event will occur that will result in a refund of taxes even though the taxpayer has no genuine way of anticipating such an event. One can speculate that the IRS may have recognized this shortcoming of allowing protective claims to be filed with so few limitations due to the strict requirements imposed on the protective claims filed pursuant to Revenue Procedure 2002-52.<sup>101</sup>

### C. The Existence and Application of Protective Claims for Refund in State Tax Laws

Virtually every state imposes a statute of limitations for filing a claim for refund, restricting the number of years that may pass before a claim for refund is time-barred, similar to § 6511 of the Internal Revenue Code.<sup>102</sup> Also, similar to the treatment received in federal tax law, at the state level protective claims have received differing treatment both among the several states and even within one individual state. Perhaps because of the historical lack of consistency in their application at the federal level, and since the IRS has yet to adopt any formal opinion on the matter generally, the states lack guidance on the issue of whether to adopt protective claims for refund at the state level. Several states do, however,

---

99. I.R.S. Field Service Advice, 199916003, Doc 1999-14773, 199 TNT 79-71. This ruling seems contrary to the various requirements that any claim for refund must set forth clearly the legal and factual grounds upon which a claim for refund is requested. See *supra* note 2 and accompanying text.

100. *Id.*

101. Rev. Proc. 2002-52, 2002-31 I.R.B. 242, available at 2002 IRB LEXIS 325 at \*40.

102. See, e.g., ALA. CODE § 40-2A-7(c)(2)(a)(i) (2002) ("A petition for refund shall be filed with the department . . . within three years from the date that the return was filed"); CAL. REV. & TAX. CODE § 19306(a) (Deering 2003) ("No credit or refund shall be allowed or made after a period ending four years from the date the return was filed"); HAW. REV. STAT. ANN. § 231-23(a)(1)(A) (Michie 2002) ("No refund shall be made unless an application for refund shall have been made within five years after the amount to be refunded was paid"); 36 M.R.S.A. § 144(1) (Supp. 2002-2003) ("A taxpayer may request a credit or refund of any tax imposed . . . within 3 years from the time the return was filed"); OKLA. STAT. ANN. tit. 68, § 227(b) (West 2002) ("Any taxpayer who has so paid any such tax may, within three (3) years from the date of payment thereof file with the Tax Commission a verified claim for refund of such tax so erroneously paid"); VA. CODE ANN. § 58.1-1823(A)(i) (Michie 2003) ("Any person filing a tax return or paying an assessment . . . may file an amended return with the Department within . . . three years from the last day prescribed by law for the timely filing of the return"); WIS. STAT. ANN. § 71.75(5) (West 2003) ("A claim for refund may be made within 4 years after the assessment of a tax").

recognize the existence of protective claims for refund, and a few of those states warrant closer attention.<sup>103</sup>

The Commonwealth of Virginia, for example, has attempted to set forth clearly its position on protective claims by providing:

Any person who has paid an assessment of taxes . . . may preserve his judicial remedies by filing a claim for refund with the Tax Commissioner on forms prescribed by the Department within three years of the date such tax was assessed. . . . [The Tax Commissioner may] hold such claim without decision pending the conclusion of a litigation affecting such claim. The fact that such claim is pending shall not be a bar to any other action under this chapter.<sup>104</sup>

There is no particular form on which to file a protective claim for refund under the Virginia provision. However, the provision does state that only protective claims that sufficiently identify the taxpayer, type of tax, taxable period, remedy sought, date of assessment and, if paid, date of payment, and include a signed statement setting forth each alleged error in the assessment and grounds upon which the taxpayer relies, will be accepted.<sup>105</sup>

The Virginia Code provision directly addresses many of the problems posed by federal cases where a taxpayer files a tax return and then a separate event or litigation, not directly involving a determination of the tax already paid, results in

---

103. State case law that appears to demonstrate the applicability of protective claims for refund at the state level includes: *Neer v. Okla. Tax Comm'n*, 982 P.2d 1071, 1082 (Okla. 1999):

Protective refund claims have been recognized by [the Oklahoma Tax Commission] . . . where the final outcome or exact amount of a refund claim is unascertainable until after the legislatively-prescribed time limit on refund claims has expired, but within such time period the taxpayer has knowledge or should know that the possibility of a refund claim exists.

*Id.* See also, *DeArmond v. Or. Dep't of Revenue*, 14 OTR 112 (January 24, 1997) *available at* 1997 Ore. Tax LEXIS 5, at \*10 (finding that the "[t]axpayers acknowledge that protective claims could have been filed to protect themselves [from expiration of the statute of limitations]"); *Forbes v. Dir., Division of Taxation*, 14 N.J. Tax 257, 264 (August 24, 1994) (stating that "[r]efund claims are frequently filed dependent on future events such as the result of future federal audits or the results of litigation"); Office of the Attorney General of the State of Washington, 1984 Op. Att'y. Gen. Wash. No. 21 (August 21, 1984) *available at* 1984 Wash. AG LEXIS 81 ("[A] taxpayer anticipating a further appeal of an assessed valuation to the Board of Tax Appeals from the county Board of Equalization can file a protective claim for a refund in superior court.").

104. VA. CODE ANN. § 58.1-1824 (Michie 2002). A protective claim for refund is defined as a claim for refund under § 58.1-1824 made "after payment of the assessment which may be used to protest any or all issues connected with an assessment and, in certain circumstances, may extend the time in which taxpayer may apply to a court." 23 VA. ADMIN. CODE § 10-20-160(A)(4) (West 2002).

105. 23 VA. ADMIN. CODE § 10-20-160(C)(1) (West 2002). This provision applies to any person who has paid an assessment. An assessment is defined as "the act of determining that a tax (or additional tax) is due and the amount of such tax. An assessment may be made by the Department or by the taxpayer (self-assessment)." *Id.* § 10-20-160(E)(1). In defining self-assessment, the Virginia Administrative Code provides, "[a] self-assessment is usually made when the taxpayer files a return." *Id.* § 10-20-160(E)(4). Further, "[a]mended returns claiming refunds under Va. Code section 58.1-1823 are not assessments or self-assessments." *Id.* § 10-20-160(E)(7).

an overpayment by the taxpayer.<sup>106</sup> Accordingly, as long as a taxpayer files the protective claim within three years from the date of payment, his application for refund is held open. Although the Virginia provision is perhaps not available in all situations, unlike the Internal Revenue Code, it provides taxpayers with a clear, unequivocal notice of their rights. This leaves no uncertainty in the minds of the Virginia taxpayers about the availability of protective claims and ensures that a court will recognize their existence during litigation.

State tax commissions have the freedom to tailor any protective refund provision to the needs of their individual administrative office. Providing for protective claims in a more limited format than that adopted by Virginia, the Idaho State Tax Commission has adopted a clear statutory provision allowing for the restricted application of protective claims that could serve as a model. In 1998, the Idaho State Tax Commission adopted a provision dealing with protective claims strictly in a manner relating to income tax returns filed at the federal level or with another state providing in part:

Filing [an amended] claim with the Internal Revenue Service to reduce taxable income does not extend the Idaho period of limitations for claiming a refund or credit of tax. If the statute of limitations is about to expire on a taxpayer's Idaho return for which an issue is pending on his federal return or return filed with another state, the taxpayer should amend his Idaho return. He should clearly identify the amended return as a protective claim for refund. The taxpayer must [also] notify the Tax Commission of the final resolution.<sup>107</sup>

This policy is distinct from other states whose tax laws provide that filing an amended claim or being engaged in litigation of a taxpayer's federal tax liability automatically serves to toll the typical statute of limitations for filing a claim for refund.<sup>108</sup>

---

106. See, e.g., *Amoco Prod. Co. v. Newton Sheep Co.*, 85 F.3d 1464, 1466 (10th Cir. 1996) (where an action to quiet title to a piece of land was the determining factor in whether one of the parties to the action had overpaid windfall profit taxes); *Swietlik v. United States*, 779 F.2d 1306, 1307 (7th Cir. 1985) (where the outcome of a criminal proceeding determined whether a taxpayer was entitled to an inheritance and in turn, whether he was responsible for paying the estate tax on such an inheritance); *Kellogg-Citizens Nat'l Bank v. United States*, 330 F.2d 635, 636 (Ct. Cl. 1964) (where a taxpayer who had filed and paid an estate tax return later received deficiency notices for unpaid income tax, resulting in an overpayment of estate tax for which a claim for refund was time-barred).

107. IDAHO ADMIN. CODE § 35.01.01.880 ¶ 07 (West 2002). This provision treats the amended return as a claim for refund consistent with paragraph three of the same section, which provides "A properly signed amended tax return shall constitute a claim for refund. The taxpayer must clearly set forth the amount claimed and explain why and how the original return is amended." *Id.* ¶ 03. It is noteworthy that the Idaho provision regarding protective claims for refund appears only in the chapter on income tax administrative rules. It could be presumed from this that the State of Idaho does not accept protective claims for other taxes or that the decision to allow taxpayers to file protective claims for refund is one that is made by the individual division, not the Department of Revenue as a whole.

108. MARYLAND COMPTROLLER OF THE TREASURY, *Maryland Income Tax Administrative Release: Administrative Release No. 20*, TAX ANALYSTS, STATE TAX TODAY, 95 STN 235-23, IV (December 7, 1995) (providing that when a taxpayer's federal income tax liability is either adjusted by the IRS, or is established as a result of litigation, the taxpayer has one year from the date of final determination to file a claim for refund with the State of Maryland); Kathleen K. Wright, *California's Refund Claim Procedures: An Analysis*, TAX ANALYSTS, STATE TAX TODAY, 95 STN 97-5 (May 19, 1995) (California law provides taxpayers with two years from the date of final determination of federal tax liability to file a claim for refund at the state level notwithstanding the general statute of limitations governing claims for refund).

The Idaho provision, like that of Virginia, clearly sets forth the taxpayers' right to file a protective claim in limited circumstances, thereby achieving the goal of providing taxpayer notice. But by requiring a taxpayer to file an amended return and label it as a protective claim, the Idaho State Tax Commission may still be left with the administrative difficulty of processing protective claims. Taxpayers who fail to clearly label the amended return as a protective claim may find their claims being sent for processing, instead of being held for further amendment. This results in unnecessary work for the administrative office and the potential that a protective claim that is properly and timely filed will be inaccurately recorded, thereby leaving the taxpayer without a remedy when a formal claim for refund is subsequently filed. Adopting a clear and concise form specifically for protective claims for refund could ease such administrative concerns. A separate protective claim form would benefit both the taxpayers, by eliminating any ambiguity in supplying the requisite information for the refund, and administrators by enabling them to properly identify and process protective claims.

An alternative to a protective claim statute that still provides a reasonably equitable result for the taxpayer was incorporated into Florida's tax administration. The statute of limitations and the availability of protective claims for refund of estate tax were at the center of a Technical Assistance Advisement issued in November 1983.<sup>109</sup> In this situation, the decedent died on August 29, 1979, and estate tax was paid on May 27, 1980.<sup>110</sup> The taxpayer provided the Department of Revenue with notice of its protective claim for refund, attempting to ensure that the estate would not be foreclosed from claiming a refund of Florida estate tax in the event that the final determination of the federal estate tax liability concluded more than four years from the May 1980 payment date.<sup>111</sup>

However, the Assistant General Counsel for the Department of Revenue determined that the letter did not constitute a valid claim for refund and did not serve to hold open the statute of limitations for a refund of estate tax.<sup>112</sup> The Technical Assistance Advisement determined that Florida statutes provide a remedy for taxpayers engaged in litigation to establish federal estate tax liability, and the filing of a protective claim for refund in this manner will not suffice.<sup>113</sup> The Technical Assistance Advisement provided that Florida statutes impose a four-year limitation on both claims and actions for refund of estate tax "unless there shall have been filed with the department written notice of any administrative or judicial determination of the federal estate tax liability of the estate . . . and such notice shall have been so filed not later than 60 days after the determination shall have become final."<sup>114</sup>

The requirement of notice of an administrative or judicial determination of federal tax liability within sixty days is a policy that is both taxpayer-friendly and administratively sound because it avoids the administrative burden of requiring taxpayers to file amended claims which cannot yet be processed because the exist-

---

109. FLORIDA DEP'T OF REVENUE, *Technical Assistance Advisement*, available at 1983 Fla. Tax. Lexis 137 (November 29, 1983).

110. *Id.* at \*1.

111. *Id.*

112. *Id.* at \*4.

113. *Id.* at \*4-5.

114. FLA. STAT. ANN. § 198.29(2) (West 2003).



ence of such claim, as well as the amount of tax to be refunded, are not final. The Florida provision as written, however, only allows a taxpayer who is an actual party to a litigation to claim a refund after the expiration of the statute of limitations.<sup>115</sup> For states wishing to adopt a similar policy, the provision should be amended to allow a taxpayer to file a claim for refund that arises from related, though not direct, litigation concluding after the expiration of the statute of limitations.

Guidance for an exemplary provision for allowing protective claims only in instances involving adjustments to federal income tax liability is found in an administrative release from Maryland.<sup>116</sup> The Maryland Comptroller of the Treasury explained that claims for refund filed after the expiration of the statute of limitations will be allowed if the IRS adjusts a taxpayer's federal liability and such adjustment results in an overpayment of taxes at the state level.<sup>117</sup> In section IV of the administrative release, the Comptroller defined protective claims for refund explicitly by stating:

A protective claim is a request for refund: (1) which is not based on a federal adjustment; (2) filed using an amended return for a specific amount; (3) with a request that the Comptroller delay acting on the refund request; and (4) the request delay is:

---

115. *Id.*

116. See MARYLAND COMPTROLLER OF THE TREASURY, *Maryland Income Tax Administrative Release: Administrative Release No. 20*, TAX ANALYSTS, STATE TAX TODAY, 95 STN 235-23, (December 7, 1995).

117. *Id.* § I(B)(2)(a). The administrative release provides taxpayers with one year from an IRS adjustment to file an amended claim with the State of Maryland. *Id.* Additionally, the same provision applies for a decision rendered by the "highest court of the United States to which an appeal of a final decision of the Internal Revenue Service is taken." *Id.* § I(B)(2)(b). The claim for refund in this situation is limited, however, "to the amount of the reduction in Maryland tax resulting from the federal income tax adjustment." *Id.* § I(B)(4). Mitigation of the statute of limitations is further available in instances involving tax liability owed to another state within a limited time frame. Section C of the administrative release provides the following:

In 1995 the legislature passed a law which created a special exception to the above statute of limitations. In pertinent part the law provides that a claim for a refund or credit for overpayment of income tax attributable to a credit for taxes paid [to] another state under section 10-703 of the Tax-General Article may not be filed after the later of:

1. the time for filing a claim for refund or credit of overpayment provided in paragraph B.1.; or
2. [one] year from the date a taxpayer receives notification that another state's income tax is due.

Example: A Maryland resident taxpayer in 1989 sells real property located in New York. There is a \$50,000 capital gain. The taxpayer reports the capital gain on the 1989 Maryland resident return but does not report the gain to the state of New York. On October 1, 1994, the state of New York notifies the taxpayer that a nonresident tax is due on the gain from the sale of property in New York. The taxpayer may not file a claim for credit for taxes paid [to] the state of New York under B.1 as the time for filing the claim under that section has expired.

*Id.* § I(C)(1)-(2).

In the example provided, the taxpayer is simply left without a remedy despite having actually overpaid tax to the State of Maryland. Although this result is harsh to the individual taxpayer, as a matter of administrative policy, it is efficient to allow only a short period for amendments in this situation.

(a) because of a pending decision by a state or federal court which will affect the outcome of the refund claim; or (b) for reasonable cause.<sup>118</sup>

Although this is an excellent protective claim provision, allowing a protective claim for reasonable cause still creates ambiguity as to its availability. Although the right to file a protective claim may be established, the determination of reasonable cause implicates an entirely new level of administrative inquiry. Furthermore, this provision creates an area of appeal from any final agency determination dismissing the protective refund claim for failure to establish reasonable grounds for filing.

Not all states provide such clear guidelines to taxpayers on the policy and procedure of filing protective claims as do Virginia, Idaho, Maryland and Florida. The State of Illinois Department of Revenue has issued several, conflicting Private Letter Rulings dealing with the validity and even existence of protective claims for refund under Illinois tax law.<sup>119</sup> In a 1984 letter, the Department of Revenue's Income Tax Legal Division notified a taxpayer that a protective claim for refund is the appropriate measure if the taxpayer does not know what adjustments to taxable income the Department of Revenue was making or would make in the future.<sup>120</sup>

However, the following year, a corporate taxpayer notified the Department of Revenue that it was under audit by the State of Texas which was likely to lead to litigation where, if the State of Texas prevailed, the taxpayer would be entitled to a refund of taxes paid to Illinois.<sup>121</sup> The taxpayer's letter to the Department of Revenue stated: "We respectfully submit this protective claim for refund in the event the State of Texas prevails in this issue," and notified the Department of the maximum dollar amount for which the claim could be filed.<sup>122</sup> In its Private Letter Ruling from the Legal Services Bureau, the Department of Revenue stated, "[t]here is no such thing under Illinois law as a 'Protective Claim.'"<sup>123</sup>

---

118. *Id.* § IV. Not surprisingly, the administrative release provides that all protective claims for refund be filed within the statute of limitations for claims for refund. *Id.* § IV(B). Maryland's statute of limitations for filing claims for refund conforms with section 6511 of the Internal Revenue Code. *Id.* § II.

119. Compare ILLINOIS DEP'T OF REVENUE, Priv. Ltr. Rul. 84-0228 (Feb. 2, 1984), available at 1984 III. PLR LEXIS 232 (establishing that a protective claim is the appropriate measure for a taxpayer who is unsure of adjustments that are being made to taxable income now or in the future) and ILLINOIS DEP'T OF REVENUE, Priv. Ltr. Rul. IT 88-0242 (Sept. 1, 1988), available at 1988 III. PLR LEXIS 1171 (holding that filing a protective claim to hold open the statute of limitations for a net operating loss carryback serves to hold open the statute of limitations for subsequent years for purposes of carrying back losses in the later years) with ILLINOIS DEP'T OF REVENUE, Priv. Ltr. Rul. 85-0379 (Apr. 9, 1985) available at 1985 III. PLR LEXIS 383 (declaring that protective claims for refund do not exist under Illinois law) and ILLINOIS DEP'T OF REVENUE, Priv. Ltr. Rul. No. IT-97-0011-GIL (Jan. 10, 1997) available at 1997 III. PLR LEXIS 69 (providing that notification of a protective claim by means such as a letter, statement or telephone conversation is not sufficient to preserve a taxpayer's right to claim a refund).

120. ILLINOIS DEP'T OF REVENUE, Priv. Ltr. Rul. 84-0228 (Feb. 2, 1984), available at 1984 III. PLR LEXIS 232.

121. ILLINOIS DEP'T OF REVENUE, Priv. Ltr. Rul. 85-0379 (Apr. 9, 1985), available at 1985 III. PLR LEXIS 383.

122. *Id.*

123. *Id.* This discrepancy could possibly be explained by noting that the Private Letter Ruling from 1984, *supra* note 119, was issued by the Income Tax Legal Division, and this Ruling was issued by the Legal Services Bureau dealing with sales and use taxes.

In an attempt to reconcile these two clearly contradictory statements of Illinois tax law, it is possible that despite having no statutory provision detailing their policy, in practice, Illinois tax law allows a protective claim to be filed with the Income Tax Division but not with the Sales Tax Division. However, such a policy seems to be administratively cumbersome for both the Department of Revenue as well as the taxpayer. In the complicated area of tax law, both taxpayers and tax practitioners would benefit greatly from a certain level of consistency in the implementation of tax policy. Although it is in more stark contrast here, the difficulty posed by these two conflicting rulings reflects much of the same inconsistency that is extracted from IRS publications regarding federal tax questions.<sup>124</sup>

In 1988, a third Private Letter Ruling was issued by a manager within the Department of Revenue, outlining the Department's position on net operating loss carrybacks.<sup>125</sup> In this instance, a taxpayer filed a timely 1983 net operating loss carryback to 1980, where the whole loss could be offset against combined unitary worldwide income.<sup>126</sup> However, due to an amendment to the Income Tax Act in 1982, the 1983 net operating loss could no longer be completely absorbed in 1980.<sup>127</sup> As a result of the recalculation, a portion of the 1983 net operating loss was available for carryback to 1981.<sup>128</sup>

In addressing the taxpayer's concern that an application of the net operating loss to 1981 would now be time-barred, the Department of Revenue found that, because the theory of the claim for 1981 (the 1983 net operating loss) was the same as the theory for the 1980 claim, "it would be administratively cumbersome and wasteful to require taxpayers to file alternative protective claims for subsequent years whenever they carryback a loss [and] the Department will deem the earliest carryback claim to serve as a simultaneous protective claim for later years for statute of limitations purposes. . . ."<sup>129</sup>

---

124. See *supra* notes 82-101 and accompanying text.

125. ILLINOIS DEP'T OF REVENUE, Priv. Ltr. Rul. IT 88-0242 (Sept. 1, 1988), available at 1988 Ill. PLR LEXIS 1171. The Internal Revenue Code contains a provision providing for net operating loss carrybacks similar to the provision at issue in the ruling. Section 172 provides in part:

(a) . . . There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year.

(b) . . . (1) . . . (A) . . . Except as otherwise provided in this paragraph, a net operating loss for any taxable year—(i) shall be a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, and (ii) shall be a net operating loss carryover to each of the 20 taxable years following the taxable year of the loss. . . .

(c) . . . For purposes of this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

26 U.S.C. § 172(a)-(c) (1984).

126. ILLINOIS DEP'T OF REVENUE, Priv. Ltr. Rul. IT 88-0242 (Sept. 1, 1988).

127. *Id.* The taxpayer's net operating loss carryback was used to offset income against combined unitary worldwide income. This net operating loss was broken out by separate unitary groups on audit, and was applied individually to members of the separate groups for 1980. The entire 1983 loss was unable to be used completely in 1983 because the 1982 amendment to the Income Tax Act precluded the inclusion of foreign members in the unitary group. *Id.*

128. *Id.*

129. *Id.* Because this Private Letter Ruling was issued from the Income Tax Department, it is consistent with the presumption discussed *supra* note 123 that Illinois tax law only allows protective claims to be filed with their Income Tax Division.

In a more recent Private Letter Ruling, it appears that the Income Tax Division began to shift its policy on what will be considered a valid protective claim for refund, avoiding an over-expansive use of such types of claims.<sup>130</sup> In the 1997 letter, a staff attorney for the Income Tax Division determined that a corporate taxpayer must file an amended return on a form prescribed within the statute of limitations to preserve its right to claim a refund.<sup>131</sup> The letter further states, "[n]otification by any other means such as a letter, statement or telephone conversation is not sufficient to preserve [the taxpayer's] right to claim a refund. . . ."<sup>132</sup>

Additionally, the letter provided that after a taxpayer is made aware of a change affecting federal taxable income, the taxpayer must notify the Illinois Department of Revenue within 120 days after the change has been finally determined.<sup>133</sup> To apply for a refund resulting from such change, taxpayers are required to file their claim for refund within two years from when the Illinois Department of Revenue should have been notified of such change, "regardless of whether such notice was actually given."<sup>134</sup>

Adopting a policy requiring a taxpayer to notify the Department of Revenue of any changes in federal income tax liability, but then allowing the taxpayer to file for a refund resulting from such a change regardless of whether notice was actually given, would appear to reward taxpayer non-compliance. One of the major concerns with imposing a duty to file a protective claim for refund without any statutory authority is that taxpayers are not put on notice of their right to file such a claim. Under the Illinois ruling, a taxpayer is required to file a notice with the Department of Revenue of a change in tax liability and is sufficiently made aware of this requirement, but the taxpayer is not precluded from filing a claim for refund if notice is not provided.<sup>135</sup> The policy seems counterintuitive and burdensome to tax administration. A tax department needs to be able to "close the books" on previous tax years and the policy adopted by the Illinois Department of Revenue appears to make this goal more difficult.

California's refund claim procedures were at the center of some criticism in a 1995 analysis of its refund provisions.<sup>136</sup> Kathleen Wright, from California State

---

130. ILLINOIS DEP'T OF REVENUE, Priv. Ltr. Rul. No. IT-97-0011-GIL (Jan. 10, 1997), available at 1997 Ill. PLR LEXIS 69. It is important to note that the rules of the Illinois Department of Revenue require that the Department issue two types of letter rulings, private letter rulings ("PLR") and general information letters. Under Illinois Income Tax law, PLRs are binding on the Department itself, "but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete." *Id.* General information letters are not binding on the Department of Revenue and do not constitute statements of agency policy or interpretation of the tax law of Illinois. *Id.*

131. *Id.* This general information letter was requested because the phrase "competent authority" was not defined under the Illinois Income Tax Act as of the time the letter was issued. The taxpayer sought a ruling on whether, "if the Japanese National Tax Authority entered into a valid treaty with the United States government, [would such treaty] control the determination of taxable income with respect to the State of Illinois for those corporations governed by the Japanese National Tax Authority." *Id.* The Department of Revenue concluded that it would. *Id.*

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.*

136. Kathleen K. Wright, *California's Refund Claim Procedures: An Analysis*, TAX ANALYSTS, STATE TAX TODAY, 95 STN 97-5 (May 19, 1995).

University, stated "California's procedures governing refund claims have never been identical with federal provisions and become particularly confusing in the area of protective refund claims."<sup>137</sup> At the time of the article, under California law, if a taxpayer was a party to pending federal tax litigation, they had an automatic right to file a claim for refund within two years of the date of the final federal determination.<sup>138</sup> Wright concludes that confusion arises if the taxpayer is not a party to pending federal litigation but, because of similar factual circumstances, would be affected by its outcome.<sup>139</sup> In this situation, the taxpayer is required to file a protective claim upon conclusion of the federal case.<sup>140</sup>

This procedure certainly does not seem to be as unreasonable as Wright suggests. A taxpayer who is not a party to the litigation, but is nonetheless affected by its outcome, should not be able to take advantage of the automatic two-year period for filing a claim for refund. California's Franchise Tax Board (FTB) is effectively put on notice of a potential claim for refund by a taxpayer who is a party to the litigation. However, the FTB would have no such notice for taxpayers who are waiting for the outcome of the litigation to be resolved, simply because they have found themselves in a similar factual situation. Requiring these taxpayers to file a protective claim before the close of the litigation serves to notify the FTB of a potential claim for refund and provides that the statute of limitations should be held open.

Wright also describes certain risks that are inherent when a taxpayer files a protective claim for refund.<sup>141</sup> She notes that the FTB may respond to a protective claim by selecting it for examination, and warns that returns that take aggressive positions on multiple issues may be denied.<sup>142</sup> Further, Wright argues that there is a real possibility that such aggressive returns will be subject to adjustments by the FTB to offset any potential refund.<sup>143</sup> Even more damaging to the taxpayer is the possibility that the FTB will "propose adjustments that create a deficiency in a year covered by the claim," because filing a claim for refund extends the period for assessment and determination of deficiency by the FTB, in addition to holding open the period for claiming a refund by the taxpayer.<sup>144</sup>

---

137. *Id.*

138. *Id.*

139. *Id.*

140. *Id.* Wright provides as an example the following:

[Consider] a taxpayer who has included a release payment from a former employer in taxable income for both federal and state purposes. Subsequently, it is determined that the release payment might in fact be excludable as an age discrimination award. The taxpayer files a refund claim at the federal level that is denied and plans to litigate. The taxpayer files a protective refund claim with the IRS to hold open the statute of limitations until a determination is made by the courts. . . . [Under California law,] if a release payment was received in 1993 and included in income for that year, the refund claim must be filed no later than four years after the due date of the return without extension or April 15, 1998. . . . A special rule applies to any taxpayer who files an amended federal income tax return that contains changes that will result in a state overpayment.

*Id.*

141. *See id.*

142. *Id.*

143. *Id.*

144. *Id.*

Wright's concern, while accurate, is open to criticism because any type of claim for refund is subject to the same sort of reaction and examination. The tax authority's treatment of returns in this manner is not likely going to be any different regardless of whether the taxpayer files a protective claim for refund or simply a general claim for refund. The IRS and any tax administrative body are likely to closely review all returns or claims for refund that take an aggressive position on an issue.

Two years after Wright's article was published, the California State Board of Equalization heard a case, in 1997, dealing directly with the issue of "[w]hether California should recognize a protective claim for refund for purposes of extending a statute of limitations which has not yet expired pending resolution of a related issue by another state."<sup>145</sup> The taxpayer in this case was a California corporation that designed, developed and marketed computer software.<sup>146</sup> In January 1987, the taxpayer opened an additional office in Massachusetts for the purposes of providing technical and marketing support to its East Coast customers, despite the fact that the number of its East Coast customers was quite small in comparison with its California-based customers.<sup>147</sup> In filing its California income tax returns for tax years 1987-89, the taxpayer took the position that the majority of its income-producing activity for those years had occurred in California.<sup>148</sup>

After an audit by the Massachusetts Department of Revenue, it was determined that the taxpayer should have included a portion of its royalty income in the numerator for the Massachusetts sales factor as well.<sup>149</sup> Payment of the Massachusetts assessments thus resulted in the payment of tax on the same income that was apportioned in two different states.<sup>150</sup> While the taxpayer's appeal was pend-

---

145. Adobe Systems, Inc., 1997 Cal. Tax LEXIS 257, at \*1 (Aug. 1, 1997).

146. *Id.* The taxpayer owned the trademark "PostScript" for "a general purpose programming language and printing application package." *Id.* The PostScript language operates by defining a document and then is used in connection with a PostScript interpreter to reproduce the page. The taxpayer licensed this interpreter and related software to computer product manufacturers within California. *Id.* at \*1-2.

147. *Id.* at \*2. "Only four out of more than forty licensees [of the PostScript interpreter] did business in Massachusetts during the [tax years at issue]." *Id.*

148. *Id.* at \*3. With this belief, the taxpayer included all of its royalty revenues "in the numerator of the California sales factor for purposes of determining the California apportionment factor." *Id.* The court explained:

Generally speaking, the Uniform Division of Income for Tax Purposes Act (UDITPA) requires that a taxpayer's unitary "business income" be apportioned by means of a three-factor formula composed of property, payroll, and sales factors. The sales factor is defined as, "a fraction, the numerator of which is the total sales of the taxpayer in this state during the income year, and the denominator of which is the total sales of the taxpayer everywhere during the income year." The term "sales" means all "gross receipts of the taxpayer," and includes gross receipts from the licensing of intangible personal property. The regulations indicate that sales of intangible personal property take place in California if, "(a) the income-producing activity is performed in [California]; or (b) [the] income-producing activity is performed both in and outside [California] and a greater proportion of the income-producing activity is performed in [California] than in any other state, based on costs of performance."

*Id.* at \*11-12 (citations omitted).

149. *Id.* at \*3. The Massachusetts Department of Revenue assessed the taxpayer additional taxes of \$22,590 for tax year 1987; \$237,380 for tax year 1988; and \$338,816 for tax year 1989. *Id.* at \*4.

150. *Id.* at \*4.

ing in Massachusetts, the taxpayer filed amended California returns alleging overpayments of taxes in amounts nearly equal to the Massachusetts' assessments.<sup>151</sup> Additionally, in the amended returns the taxpayer requested that the Board of Equalization delay its final resolution until the appeal in Massachusetts was decided.<sup>152</sup>

The Board of Equalization noted that, as of the time of hearing this case, "[t]he Revenue and Taxation Code does not expressly recognize a 'protective claim for refund,' nor [is the Board] aware of any procedural mechanism to extend the statute of limitations or which otherwise requires [the] Board to defer a decision pending action by another state."<sup>153</sup> In a footnote, the Board distinguished the situation of the taxpayer with that of one involving a protective claim filed to protect rights of a taxpayer pending final determination of a federal action which will directly affect the tax owed at the state level.<sup>154</sup> The Board held that because the taxpayer's claims were not yet barred by the statute of limitations, the doctrine of equitable tolling did not apply.<sup>155</sup>

Further, the Board refused to fashion an alternative remedy for the taxpayer.<sup>156</sup> In backing its refusal, the Board asserted:

---

151. *See id.* at \*5. The returns filed by the taxpayer claimed an overpayment of tax in the amounts of \$29,512, \$200,109, and \$298,174 for the 1987, 1988, and 1989 income years, respectively. Under California tax law, amended returns are treated as claims for refund. *Id.* (citing CAL. REV. & TAX. CODE § 19307 (Deering 2003)). The amounts of the overpayments claimed by the taxpayer reflected the "difference in California tax which would result if [the taxpayer's] license fees were attributed to Massachusetts in accordance with the decision of the [Massachusetts Department of Revenue]." *Id.* The claim for refund stemming from income year 1987 reflected "a downward adjustment in the California property factor based on the capitalization of rental income." *Id.* at \*5 n.3.

152. *Id.* at \*5. Under California law, there is a four-year statute of limitations for filing a claim for refund. *See* CAL. REV. & TAX. CODE § 19306 (Deering 2003). However, "[t]hat period may be prolonged if the taxpayer agrees to extend the time period within which [the California Tax Board] may issue a deficiency assessment." Adobe Systems, Inc., 1997 Cal. Tax LEXIS 257, at \*6 (citing CAL. REV. & TAX. CODE § 19308(a) (Deering 2003)). In this case, the taxpayer filed the amended returns for tax years 1987 and 1988 on June 29, 1993, but the returns were considered timely because the taxpayer had previously agreed to extend the period that the California Tax Board could issue deficiency assessments to June 30, 1993, pursuant to section 19308(a). *Id.* at \*7.

153. *Id.* at \*7-8. The Board noted further, that "regardless of the lack of legal authority for [taxpayer's] position, we do recognize that [the taxpayer] asks this Board to create a remedy addressed to its particular, and somewhat unfortunate, situation based in part on the doctrine of equitable tolling . . . ." *Id.* at \*8. The Board explained:

Equitable tolling is a doctrine which allows for the suspension of a statute of limitations so as to protect the claim of an individual who has several legal remedies and, reasonably and in good faith, pursues one of those remedies in order to eliminate the need to pursue another. Application of the doctrine requires, "timely notice, and lack of prejudice, to the [respondent], and reasonable and good faith conduct on the part of the [taxpayer]." The doctrine has been applied to actions against governmental agencies and also when the action involves a claim for refund of taxes.

*Id.* at \*8-9 (citations omitted).

154. *Id.* at \*8 n.5.

155. *Id.* at \*10. The Board stated:

It appears that [the taxpayer] has taken every possible step to keep respondent apprised of the status of the Massachusetts action and to avoid any prejudice to respondent's position at some later date. For these reasons, should respondent assert the statute of limitations as a bar to a subsequent proceeding, [taxpayer] would appear eligible for relief pursuant to the equitable tolling doctrine."

*Id.* at \*10 n.7.

156. *Id.* at \*10.

First, to recognize a protective claim for refund as a remedy for [the taxpayer's] procedural dilemma would be contrary to our previous rulings that a determination by another state as to the taxation of the same income taxed by California is not material in an appeal to this Board.<sup>157</sup> Second, our Board is charged with interpreting the law as enacted by the Legislature, we do not have the authority to change that law, nor to create new laws. For these reasons, we cannot approve any further delay in resolving [the taxpayer's] claim for refund based on the merits.<sup>158</sup>

Authorizing protective claims to be filed as a result of a change in federal tax liability but not because of changes made by another state can be viewed largely as a political compromise. This provides a more equitable situation for the taxpayer and also reduces the amount of administrative work for the tax authority. One of the considerations that a tax authority would be concerned with in allowing taxpayers to file a protective claim as a result of changes in tax liability from another state is that each state's tax laws can differ dramatically. These changes may result in a more cumbersome protective refund procedure.

Variations in and among the states on the existence and validity of protective claims for refund are vast. Further, for those states that do accept protective claims, the circumstances under which one may be filed are not always consistent. The states could benefit from a definitive federal provision authorizing protective claims by modeling their own provisions after those adopted by Congress at the federal level.

### III. CONSTITUTIONAL CONSIDERATIONS

Tax administration can be viewed, in part, as a give and take between two constitutional considerations: Congress exercising its constitutional right to lay and collect taxes through the IRS,<sup>159</sup> and Congress providing the taxpayer with due process<sup>160</sup> through notification of their rights and remedies in the midst of complicated federal and state tax laws.

The New York City Tax Appeals Tribunal addressed the issues of the availability and constitutionality of protective claims for refund in May 2000.<sup>161</sup> *In re Fried, Frank, Harris, Shriver & Jacobson*<sup>162</sup> involved a partnership that was rent-

---

157. *Id.* at \*10-11 (citing Appeal of Melvin A. and Adele R. Gustafson, 88-SBE-027, Nov. 29, 1988; Appeal of Western Power Products, Inc., Cal. St. Bd. of Equal., Feb. 6, 1980).

158. *Id.* at \*11. In deciding the merits of the case, the Board of Equalization determined that the royalties received from the licensing contracts constituted "gross receipts from the licensing of intangible personal property and should be attributed to California for purposes of determining [the taxpayer's] California sales factor." *Id.* at \*13. Further, the Board concluded that nearly all of the royalty income producing activities took place in California and that the services provided by the taxpayer in its Massachusetts office were minimal when viewed in context of all of the royalty income. *Id.* at \*14.

159. U.S. CONST. art. I, § 8, cl. 1. "The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the Common Defence and general Welfare of the United States . . . ." *Id.*

160. U.S. CONST. amend. XIV, § 1. "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law . . . ."

161. *In re Fried, Frank, Harris, Shriver & Jacobson*, TAT (H) 97-16 (CR) (May 12, 2000), available at 2000 N.Y. City Tax LEXIS 14 (unpaginated decision).

162. *Id.*



ing commercial office space in Manhattan pursuant to a lease which provided that a portion of the rent was based on the landlord's property tax on the building.<sup>163</sup> The taxpayer leased the space beginning in 1980, but ownership of the building changed hands in 1990.<sup>164</sup> Absent any knowledge of the tenant, the landlord entered into litigation regarding property tax reductions, which lasted for eight years and resulted in a reduction of the landlord's back property taxes.<sup>165</sup> The portion of this reduction, including interest, which was attributable to the percentage paid by the tenant, amounted to more than \$4,000,000.<sup>166</sup> As a result of receiving this refund, the tenant filed various requests for refund of Commercial Rent or Occupancy Tax (CROT).<sup>167</sup> The refund requested for fiscal year 1993 was denied by the Department of Finance who subsequently conducted an audit of the tenant's CROT returns and issued a deficiency notice based upon its findings.<sup>168</sup>

The litigation focused on the availability of the tenant's right to claim refunds of CROT subsequent to the audit, and on whether the tenant was under an obligation to file protective claims for refund to hold open the statute of limitations.<sup>169</sup> Initially, in addressing the New York Department of Finance's existing policy on protective claims, the court stated in its findings of fact:

The Department has not published procedures for filing refund claims that are contingent upon the occurrence of a future event ("Protective Refund Claims"). However, taxpayers have filed such claims with respect to both income and excise taxes, including the [Commercial Rent or Occupancy Tax], and the Department has established internal procedures for processing such claims. These procedures involve setting up a file for each Protective Refund Claim and holding it in abeyance until the event that caused the need for the claim has been concluded and the taxpayer provides the Department with the relevant information necessary to substantiate the claimed refund.<sup>170</sup>

---

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.* The tenant's lease provided in relevant part:

In the event that Landlord shall receive a refund of taxes as a result of a reduction in Taxes for any Tax Year . . . Landlord shall credit [the taxpayer's] Proportionate Share of the net amount of such refund (after deducting therefrom all expenses, including, but not limited to, the fees of attorneys and experts incurred by Landlord in connection therewith) against the next accruing installment or installments of Rent to become due and payable to Landlord from [the taxpayer] or, if no further installment of Rent is to become payable, shall remit such share, or the balance thereof not theretofore credited on account of Rent, to [the taxpayer] within thirty (30) days after the receipt of such refund . . .

*Id.*

167. *Id.* The Commercial Rent or Occupancy Tax (CROT) provision provides the following in relevant part:

[E]very tenant shall pay a tax of two and one-half per centum of his or her base rent for such tax year where his or her base rent is not in excess of twenty-five hundred dollars per year or where his or her base rent is for a period of less than one year and would not exceed twenty-five hundred dollars for a year if it were paid on an equivalent basis for an entire year or a tax of five per centum of his or her base rent for such tax year where his or her base rent is in excess of twenty-five hundred dollars per year . . . ."

N.Y., N.Y. ADMIN. CODE § 11-702(a)(1) (2001).

168. *In re Fried, Frank, Harris, Shriver & Jacobson, TAT (H) 97-16 (CR).*

169. *Id.*

170. *Id.*

Because the litigation to determine the landlord's property tax lasted for eight years and the tenant was neither a party to, nor aware of, such litigation, the opportunity to claim refunds for certain years was time-barred before the litigation was even concluded.<sup>171</sup> The tenant argued to the tax appeals tribunal that being denied the opportunity to file a claim for refund for those years and requiring the tenant to "have availed itself of an undisclosed, undocumented and unsubstantiated procedure" by filing a protective refund claim, amounted to a denial of due process.<sup>172</sup>

The court conceded that the tenant was correct in its assertion that there are no statutory provisions, regulations, or published instructions to inform the public of the availability of protective claims for refund.<sup>173</sup> The court stated, however, that "[t]o satisfy the Due Process Clause of the United States Constitution, [New York City] 'must provide taxpayers with, not only a fair opportunity to challenge the accuracy and legal validity of their tax obligation, but also a "clear and certain remedy."'"<sup>174</sup> The tenant contended that being denied the opportunity to amend one of its returns as a result of the litigation deprived it of "any meaningful opportunity to challenge" the overpayment of the Commercial Rent or Occupancy Tax.<sup>175</sup>

Despite this concession in favor of the tenant, in dismissing the due process argument, the court declared, "guidance can be gained from federal and state case law which indicates that *no specific provision* authorizing Protective Refund Claims [is] necessary to provide Due Process."<sup>176</sup> In so holding, the court relied on *Swietlik v. United States*,<sup>177</sup> and *Kellogg-Citizens National Bank v. United States*,<sup>178</sup> to find that "a taxpayer's obligation to file a Protective Refund Claim to avert a statute of limitations bar is well established in both federal and state decisions."<sup>179</sup>

The decision further notes that other courts have required protective claims to be filed despite the fact that there is no such explicit taxpayer right published either in the Internal Revenue Code or in any Treasury regulation.<sup>180</sup> However, the court did recognize that, although the IRS has provided taxpayers with the option to file a protective claim in various circumstances, providing such an option is

---

171. *Id.* The landlord litigated its property taxes on the building for eight years with the City of New York and ultimately had its property taxes reduced for years 1985 through 1992. The tenant did not become aware of the retroactive reduction in property taxes until January 1992. *Id.*

172. *Id.*

173. *Id.*

174. *Id.* (quoting *McKesson Corp. v. Div. of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 39 (1990)).

175. *Id.*

176. *Id.* (emphasis added).

177. See *supra* note 75 and accompanying text.

178. See *supra* note 34 and accompanying text.

179. *In re Fried, Frank, Harris, Shriver & Jacobson*, TAT (H) 97-16 (CR).

180. *Id.* The court explained:

In recognizing [the remedy of filing a protective claim for refund], courts have not only rejected similar arguments that an adequate refund claim could not be presented within the statutory period because neither the existence nor the amount of the tax liability had been settled, but have specifically held that where there is a potential that a refund might be due, taxpayers must file protective claims to avert the bar of limitations.

*Id.* (citation omitted).

certainly not the same as establishing the right of a taxpayer to file protective claims through a specific provision in the Internal Revenue Code.<sup>181</sup> Irrespective of this notion, the court dismissed the tenant's due process argument by relying on *Kellogg-Citizens National Bank*, and finding that "[i]t is not necessary that there be a specific Internal Revenue Service pronouncement in order for a taxpayer to file a federal Protective Refund Claim" and that due process is provided by the general provision for filing a claim for refund.<sup>182</sup>

It is troubling that the court relies on the general refund provision to dismiss the taxpayer's due process claim as providing adequate notice to the taxpayer of the availability of a protective refund claim. In essence, the court is expecting often unsophisticated and unrepresented taxpayers to extract the availability of filing a protective claim from the general statute of limitations provision. While it may not be unreasonable to expect a taxpayer who is involved directly in litigation to determine his or her tax liability to at least contact the appropriate tax authority to inquire about available options for holding open the period for claiming a refund, here the court is applying the same standard to a taxpayer who had no knowledge, nor any reason to know, of the litigation that was ensuing with the landlord and that resulted in its overpayment.

Although the court did not consider it significant enough to warrant a different holding, the court did recognize the "administrative complexities" that are created by requiring taxpayers to file protective claims for refund when there is no express provision establishing such a right, nor any provision outlining the procedure to follow.<sup>183</sup> The court felt this was particularly true in conjunction with the CROT in light of the frequency that leases in the New York City metropolitan area contain provisions dealing with reductions in a landlord's property taxes.<sup>184</sup>

Even though the court rejected the due process argument made by the taxpayer in this case, the argument still deserves consideration by lawmakers. Ensuring

---

181. *Id.*

182. *Id.* The court stated that the taxpayer's remedy was availed in Code section 11-709(a), which provides in relevant part that:

[T]he commissioner of finance shall refund or credit, without interest, any tax, penalty or interest erroneously, illegally or unconstitutionally collected or paid, if written application to the commissioner of finance for such refund shall be made within eighteen months from the date fixed by this chapter for filing a return on which such payment was based or within six months of the payment thereof, whichever of such periods expire the later.

*Id.* (quoting N.Y., N.Y. CODE § 11-709(a) (2001)). The court dismissed the tenant's argument that the general refund provision did not provide the taxpayer with due process of law because at the time the tax was originally paid, it was not collected erroneously or illegally since it was properly calculated on the basis of the landlord's property taxes as established at the time of filing.

183. *Id.*

184. *Id.* The court's opinion stated:

Real estate tax escalation clauses are a common feature in commercial leases in [New York City] and many commercial landlords in the City routinely contest their real property tax assessments. Accordingly, to prevent a statute of limitations bar similar to that which occurred here prudent tenants may routinely choose to file Protective Refund Claims. While extending the . . . statute of limitations for such refund claims would be less onerous for all concerned, such relief was not requested and is not within the scope of my authority.

*Id.*

ing that taxpayers have adequate notice of their rights is a crucial aspect of sound tax policy. Placing all taxpayers on notice of the avenues available to them for retaining their right to claim a refund will ensure that, regardless of whether they are well versed in tax law, or unsophisticated and unrepresented taxpayers, they will be able to easily identify the necessary steps to protect their right to claim a refund.

#### IV. REQUEST FOR CONGRESSIONAL AMENDMENT TO THE INTERNAL REVENUE CODE

Although it appears settled that the IRS fully recognizes the existence of protective claims for refund under federal tax law despite there being no formal provision, the applicability of and requirements for protective claims is far from well-established. The instability caused by the inconsistent application of protective claims violates the principles of horizontal equity, that of treating taxpayers in similar situations in a similar manner.<sup>185</sup> To rectify this violation, Congress should adopt an amendment to the Internal Revenue Code setting forth guidelines for taxpayers wishing to file protective claims. At the very least, the IRS should adopt a formal regulation that addresses the availability of protective claims for refund generally, and prescribes the requirements of a valid claim.

The amendment should include clear, concise procedural requirements for filing a protective claim, similar to those found in Revenue Procedure 2002-52.<sup>186</sup> Taxpayers should be required to present as much information to the IRS as is available at the time of filing. Protective claims should be submitted on a form prescribed solely for the purposes of protective claims and should not require immediate administrative action be taken. Claims should include a statement that the information submitted is true and accurate under the pains and penalties of perjury. Taxpayers should provide a reasonable estimate of the amount of the potential refund, if available, and an approximation of when the protective refund claim is expected to be final. If indeed such a refund materializes, the IRS will have at least some estimate of the refund that is to be awarded. Taxpayers who file protective claims because of their own ensuing litigation should be provided sixty days to perfect the claim for refund after conclusion of such litigation. This will serve to quickly resolve the matter at the administrative level.

A protective claims amendment should further seek to establish under which circumstances a taxpayer is required or entitled to file protective claims to avoid the time bar of section 6511. Further, the provision should explain what information is necessary to constitute a valid protective claim regarding the contingent events that may give rise to the refund. Congress should seek to reconcile the competing ends of administrative efficiency with a provision that protects the rights

---

185. MICHAEL J. GRAETZ & DEBORAH H. SCHENK, *FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES* 25 (4th ed. 2001). The authors provide:

Tax equity requires that those with greater ability to pay taxes should pay more tax. It follows that those with equal ability to pay taxes should pay equal amounts of tax. In other words, for it to be "fair," it should not impose significantly different burdens on persons in similar economic situations. This requires a determination of what are "similar economic circumstances" so that we can determine the identity of our equals.

*Id.*

186. See *supra* note 12; see also *supra* text accompanying note 86.

of taxpayers. Both of these goals can be achieved if taxpayers are adequately notified that a protective claim for refund is appropriate when the statute of limitations is due to expire in the following circumstances:

- (1) If the taxpayer is a party to a litigation that will directly determine their tax liability;
- (2) If the taxpayer is party to a litigation that will indirectly determine their tax liability;
- (3) If there is on-going litigation or legislation to which the taxpayer is not a party, but which is so factually and legally intertwined that the resolution of such litigation or legislation will directly affect the taxpayer's liability.

Providing taxpayers with the opportunity to file protective claims in these situations will achieve a fair equitable result to the taxpayer and provide the IRS with adequate notice of potential claims without subjecting the IRS to undue paperwork and processing.

## V. CONCLUSION

Had a protective claim provision been available in *Kellogg-Citizens National Bank*, the estate would have been aware that it was required to file a protective claim for refund of estate taxes prior to, but depending on, the final income tax determination. The estate would therefore have received its refund and avoided the litigation altogether. Further, a distinct protective claims provision would have allowed Judge Posner and Judge Murnhagen to avoid having to speculate on Congressional intent for cases involving section 6511, and allowing the two judges to reach a consistent result in both cases.

Concrete action by the IRS to establish a framework for protective claims will serve as an impetus to the States to take affirmative steps to either adopt or unconditionally disallow the filing of a protective claim at the state level.<sup>187</sup> No longer will courts and administrative boards be required to rely on inconsistent federal case law to determine whether and to what extent protective claims should be allowed in state tax law cases. Taxpayers who are pursuing a claim unrepresented by legal counsel will have a more accurate understanding of their rights and duties

---

187. The Author notes that at the time of writing this article, the 121st Maine Legislature, in connection with Maine Revenue Services, proposed a protective claims provision to be added to the State tax laws. Legislative Document number 1571 provides in part:

1. A person who has paid any tax . . . may file a protective claim for refund. As used in this section, 'protective claim for refund' means a refund claim filed in order to protect the taxpayer's potential right to a refund of tax in the event that a related contingency occurs after the expiration of the period . . . for filing a refund claim. . . . The provisions of this section apply only to that portion of a refund claim that is dependent upon the occurrence of the related contingency.
2. . . . At the discretion of the assessor, a protective claim for refund may be held without decision until the expiration of 4 years from the filing of the protective claim for refund or until the occurrence of the related contingency.
3. . . . A final claim for refund must be filed within the earlier of the following dates:
  - A. Ninety days from the occurrence of the related contingency;
  - B. Ninety days from the taxpayer's receipt of notice of denial of the protective claim for refund.

S. 530-1571, 1st Sess., at 1 (Me. 2003). This version of LD 1571 was introduced on April 14, 2003; however, the protective claims provision was deleted prior to the enactment of the bill.

when filing a protective claim. Moreover, a clear protective claims provision will reduce the need for litigation of this issue, thereby conserving judicial resources. Uncertainty in tax law creates administrative hardship and disparate results for taxpayers. A better policy, one of clarity and uniformity, will serve the interests of all parties involved.

*Kristy M. Bowden*

