



International Tax ADVISORY ■

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Foreign Tax Credit Refund Claim Denied as Untimely

Schaeffler v. United States (5th Cir. 2018) ruled that a taxpayer's refund claim was untimely even though the amount of the claim had been affected by an adjustment to the taxpayer's foreign tax credit. Normally, a refund "attributable to" an adjustment to foreign taxes can be claimed within 10 years of the due date of the affected U.S. tax return. However, in this case, the court held that the refund was not attributable to the foreign tax adjustment because the taxpayers' foreign taxes actually decreased.

Section 6511(a) generally provides that taxpayers must file refund claims within three years of the filing date of a return or two years from the payment of tax, whichever is later. In some cases, however, the Code offers a longer period in which to file a refund claim. At issue in *Schaeffler* was the exception for refund claims related to an overpayment "attributable to" taxes paid or accrued to a foreign country in Section 6511(d)(3)(A), which allows a taxpayer 10 years from the date prescribed by law for filing the tax return for the year the foreign tax is paid or accrued to file the claim.

The taxpayers had claimed a foreign tax credit in the year that the foreign taxes accrued (2002), not the year the taxes were actually paid. Consequently, under Section 905(c), the taxpayers were obligated to inform the IRS if the foreign taxes they actually paid varied from the amount accrued and claimed as a credit. The taxpayers complied with this requirement by filing the amended return, which included two changes: (1) a decreased foreign tax credit relating to German tax liabilities; and (2) an increase in the minimum tax credit allowed under the alternative minimum tax rules. The net effect of these changes was an overpayment, for which the taxpayers claimed a refund.

The IRS denied the claim, concluding that the 10-year refund claim period did not apply because the overpayment was not attributable to foreign taxes paid or accrued. The district court, siding with the government, dismissed the taxpayers' suit for refund for lack of subject-matter jurisdiction due to untimeliness. The taxpayers appealed.

The Fifth Circuit observed that the phrase “attributable to” is not defined in the Code and has no specific meaning under the tax laws. (Regulations under Section 864 illustrate when certain stock or securities are “deemed to be attributable to” a U.S. office for purposes of the effectively connected income rules, though there is no general statutory definition.) Without guidance from the tax laws, the court resorted to the plain meaning of the phrase “due to, caused by, or generated by.”

The taxpayers argued that the changes in the German taxes and subsequent U.S. tax redetermination were “inextricably intertwined” causes for the overpayment, relying on the 2013 U.S. Supreme Court case *United States v. Woods*. The Fifth Circuit found the reliance on *Woods* to be misplaced and agreed with the IRS that the overpayment could not be attributable to foreign taxes because the taxpayers’ German tax liability had actually *decreased*. According to the court, the increase in the 2002 minimum tax credit, not the foreign taxes, caused the overpayment, meaning that the 10-year period did not apply.

The taxpayers also contended that their refund claim was timely under the general rule of Section 6511(a) because the claim was filed within two years from the time the 2002 tax was paid. This contention rested on the taxpayers’ belief that offsetting the reduction in their foreign tax credit with their minimum tax credit carryover constituted a “payment” of tax.

The court rejected this position, unpersuaded that the application of a tax credit counts as a payment for purposes of Section 6511. As the term “paid” is not defined in the relevant Code section, the court again fell back on “ordinary meaning.” Citing three dictionaries, the court concluded that the statutory phrase “tax was paid” meant that “money was transferred to satisfy a tax liability.” Because the taxpayers had not transferred money to the IRS to pay tax within two years of the 2013 amended return filing, their refund claim was not timely. Notably, the court seemed to ignore the more flexible parts of the quoted definitions of “pay” or “payment”—e.g., “to discharge indebtedness,” “to discharge or settle,” or “the money or other valuable thing so delivered in satisfaction of an obligation” (emphasis added)—that arguably could have encompassed the taxpayers’ situation.

Schaeffler is, of course, a cautionary tale on the importance of statutory limitations periods. But it is also a prime example of how even seemingly straightforward provisions are open to interpretation. The Code uses dozens of words and phrases that it does not define. “Attributable to” appears nearly 400 times, from Section 1 to Section 9712. “Trade or business” is another important, oft-repeated, yet notoriously undefined term. And despite courts’ to-do about “plain” or “ordinary meaning,” the fuzzy contours provided by judicial and administrative authorities may offer little solace (or predictability) to taxpayers who reasonably see things differently.

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