



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL,

Attn:

FROM: JASPER L. CUMMINGS, JR.

SUBJECT: Insolvent Subsidiary Member of Consolidated Group Seeking
a Refund

This Field Service Advice responds to your memorandum dated June 19, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

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LEGEND

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Common Parent Corp.	=
Sub 1	=
Sub 2	=
State X	=
Executive 1	=
Executive 2	=
\$B	=
\$C	=
\$D	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Year 5	=
Month B	=
Industry Z	=

ISSUES

1. Where the District Director, pursuant to authority provided under Treas. Reg. section 1.1502-77(a), has broken the common parent's agency authority to act for a member of the consolidated return group, are the tax returns to be filed by the receiver of that subsidiary member of the group separate returns or consolidated returns?
2. In view of the fact that the Service has broken the common parent's agency for a given consolidated return year with respect to a subsidiary member, should the Service then issue a refund for that consolidated return year directly to the subsidiary member?
3. Should the District Director, under the authority of Treas. Reg. section 1.1502-77(a), break agency between the common parent and one of its members, a subsidiary in receivership, with respect to the Year 1, Year 2 and

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Year 3 tax years, so that the receiver for the subsidiary can file amended returns for those years?

CONCLUSIONS

1. The Year 4 and Year 5 returns filed by the subsidiary in receivership only on its own behalf should each be a consolidated return. The consolidated returns must each include all items of income and expense with respect to the consolidated group and not just that subsidiary's items of income and expense.

Once a group of corporations files a consolidated return, they must continue filing as a consolidated group unless certain exceptions are met. Hence, in the instant case, consolidated returns must be filed. Also, because the subsidiary cannot act as agent with respect to the other members of the group, the subsidiary can only file a consolidated return on its own behalf.

2. Having broken the common parent's agency with regard to a subsidiary for a given consolidated return year, the Service should not issue a refund to any member of the group without having first interplead the other members of the group in a refund action to be filed by the member seeking the refund.
3. We recommend breaking agency with respect to Year 1, Year 2, and Year 3 under the authority of the last sentence of Treas. Reg. section 1.1502-77(a).

FACTS

Common Parent Corp. is the common parent of the Common Parent Corp. consolidated group. Common Parent Corp. is a holding company and purportedly has little or no assets beyond the stock it holds in two subsidiaries, which are an Industry Z company, Sub 1, and a defunct company, Sub 2. All of the three affiliated corporations were incorporated in State X.

The three affiliated corporations filed consolidated returns for the Year 1 through Year 3 (tax years). According to the revenue agent, Year 1 was the first year for which consolidated returns were filed for the affiliated group. Executive 1 was the president and/or CEO of each of the three corporations for those years. According to the field agent, Executive 1 signed the Common Parent Corp. consolidated group returns for each of Year 1 through Year 3.

Receivership

In Month B of Year 5, Sub 1 was insolvent and placed in receivership in State X. We are not certain when Sub 2 became defunct. Common Parent Corp. continues

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to exist as a State X corporation. Common Parent Corp. is not in receivership and Executive 1 continues to be the CEO and only principal officer remaining at Common Parent Corp. Despite having the responsibility for filing the Common Parent Corp. consolidated group return, Executive 1 refuses to sign or file the Common Parent Corp. consolidated group return for tax years Year 4 and Year 5. Therefore, the three affiliated corporations have not filed a tax return (neither consolidated nor separate returns) for Year 4 or Year 5.

The state-court-appointed receiver, pursuant to his duties, intends to file the Year 4 and Year 5 returns for Sub 1. He knows, however, that only consolidated returns can be filed.¹ Treas. Reg. section 1.1502-77 provides that the common parent can file a consolidated return on behalf of the members of a consolidated group.

Prior National Office and District Counsel Advice

Pursuant to the last sentence of Treasury Regulation § 1.1502-77(a), the District Director sent a letter to Common Parent Corp. informing the sole officer in his capacity as representative of the parent that, with regard to the tax liabilities of the consolidated group for Year 4 and Year 5, the Director was breaking the agency relationship between Common Parent Corp. and Sub 1 with regard to these two tax years. Common Parent Corp. was thus notified that the Service would then be dealing directly with Sub 1 as to its consolidated tax liability for these tax years.²

A second letter was sent to the receiver, informing him that, with respect to Year 4 and Year 5, the Director would no longer recognize the agency relationship of Common Parent Corp. with Sub 1. No action was taken with respect to breaking the parent's agency with the defunct subsidiary. The Service informed the receiver, that once the agency relationship between the common parent and that subsidiary was broken, Sub 1 can act for itself in signing a consolidated return. However, the Service emphasized that given the fact that the return would be filed by Sub 1 only on its own behalf, not on behalf of the consolidated group, Sub 1 lacked the authority to act for any other member. The Service also notified the receiver that, pursuant to IRC § 6012(b)(3), the return filed by Sub 1 must be executed by its receiver.

¹Under the consolidated return regulations, once an affiliated group files a consolidated return, the group must thereafter continue filing consolidated returns unless the group deconsolidates or it obtains the Service's permission to stop filing consolidated returns. In the instant, neither condition is present.

²Each subsidiary is severally liable for the entire consolidated return tax. See Treas. Reg. section 1.1502-6.

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The Year 4 and Year 5 returns were prepared as consolidated returns with a signature line as "Common Parent Corp., % xxxxx, Receiver for Sub 1".

Additional Facts After the Year 4 and Year 5 Returns Were Prepared

After the District Director sent the letter breaking agency for Year 4 and Year 5, the Receiver's counsel contacted the District Counsel again indicating that not only did the receiver want to file the original returns for Year 4 and Year 5, but the receiver wanted to file amended returns for the years Year 1 through Year 3. According to the accountants for the receiver, the Year 5 consolidated return prepared by Sub 1 results in a loss that will be carried back to those earlier tax years. The attorneys for the receiver stated that the Year 1 amended return would reflect an additional tax liability of approximately \$D,³ while the Year 2 through Year 4 returns would together reflect overpayments of approximately \$B, resulting from a Year 5 NOL carryback.

According to the District Counsel attorney, approximately \$C in prepayments are being held for the group by the Service for Year 4. The receiver's attorneys' statements indicate that these payments were made with funds provided by Sub 1.

Because the receiver was fearful that the refunds might be sent to Common Parent Corp., the receiver has sought advice from the District before filing any of the returns or amended returns to confirm that the returns had to be consolidated returns and to determine how to insure that the refunds would be sent to the receiver. District Counsel seeks advice as to how to proceed.

LAW AND ANALYSIS

Introduction

Once an affiliated group of corporations elects to file a consolidated return, it is required to file a consolidated return for subsequent years. The consolidated group can only cease filing consolidated returns where there is a deconsolidation or where an election is made by the common parent to discontinue such filing. See Treas. Reg. section 1.1502-75(a)(2). A request to cease filing consolidated returns must be made by the common parent, who must also demonstrate good cause. See Treas. Reg. § 1.1502-75(c)(1)(i). In the facts before us, since there was no deconsolidation nor election to discontinue filing consolidated returns, the consolidated group must continue to file consolidated returns.

Typically, the Service deals with the common parent, as the sole agent, for matters relating to the tax liability of the consolidated group. According to Treasury

³Resulting from an AMT adjustment.

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Regulation § 1.1502-77(a), the parent "shall be the sole agent for each subsidiary in the group, duly authorized to act in its own name in all matters relating to the tax liability for the consolidated return year". The consolidated return is filed by the common parent for the whole consolidated group.

A consolidated return must be filed by the common parent of the group. When the common parent of a consolidated group files a return as agent for the group, it is as if each and every member of the consolidated group has filed a consolidated return. See, generally, Treas. Reg. section 1.1502-77(a).

In the facts before us, the only remaining officer of the Common Parent Corp. refuses to cooperate in signing and filing the consolidated returns for Year 4 and Year 5. According to our understanding of the facts, the receiver was concerned that, under IRC Sections 6012(b)(3) and 6151, the receiver is a party statutorily responsible to meet Sub 1's federal tax obligations. Based on the circumstances of this case and authority granted under the last sentence of Treas. Reg. section 1.1502-77(a),⁴ the District Director broke agency between Sub 1 and Common Parent Corp. in order to deal directly with Sub 1 with respect to Year 4 and Year 5.

The decision to break agency for Year 4 and Year 5 was a practical decision to expedite the filing of the returns by the receiver. The decision to break the agency was based on numerous factors, including: 1. the unique circumstances where the only remaining officer of the common parent refuses to sign the consolidated returns; 2. the receiver of Sub 1 seeks to fulfill his obligations with respect to filing returns; and 3. the common parent is a mere holding company.

Issue # 1 The Year 4 and Year 5 returns filed by Sub 1

The Year 4 and Year 5 returns filed by Sub 1 must be consolidated returns and therefore must include all of the consolidated group's income and expenses. Although Sub 1 must file a consolidated return, such return is only filed by Sub 1 on its own behalf and not on behalf of the other two members of the group.

Under Treas. Reg. section 1.1502-6, Sub 1 is severally liable for the entire tax liability with respect to the entire consolidated group. Under IRC section 6012(b)(3), a receiver is authorized to make the return of income for Sub 1 "in the same manner and form as corporations are required to make such returns."

⁴According to the last sentence of Treasury Regulation section 1.1502-77(a) "Notwithstanding the provisions of this paragraph, the District Director may, upon notifying the common parent, deal directly with any member of the group in respect of its liability, in which event such member shall have full authority to act for itself".

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Because Sub 1 is a member of a consolidated group, it must file a consolidated, rather than a separate, return. See Treas. Reg. section 1.1502-75(a)(2). Once the agency relationship between Common Parent Corp. and Sub 1 is broken, the receiver should file a consolidated return on its own behalf with regard to the consolidated group's tax liability. See Treas. Reg. section 1.1502-77(a).

Sub 1 must file a consolidated return for all of the items of income and expense of the group even though such return will only be a filing of the consolidated return by this one subsidiary and not the other two corporations. See Treas. Reg. sections 1.1502-6 and 1.1502-77(a). The filing of the consolidated return by Sub 1 will constitute a consolidated return filed only by that subsidiary.

Issue #2 Refunds

In the case of an affiliated group of corporations that files consolidated income tax returns, the common parent of the group is the agent for all the members of the group. Treas. Reg. section 1.1502-77(a). Accordingly, a common parent can file the refund claim on behalf of the members of the group. In the instant case, Common Parent Corp. is still in existence, has a charter, and is still operating. See Treas. Reg. section 1.1502-77(a). Unfortunately, in the facts before us, the common parent will not file a consolidated return as its only remaining officer is recalcitrant as to signing and filing the consolidated return.

Under I.R.C. section 6402(a) and the regulations thereunder, the Service may refund an overpayment to the person who made the overpayment. In the instant case, it may be difficult to determine which member actually paid the Year 4 tax for which the refund is being sought. It is our understanding that Sub 1 purportedly had incurred most of the income and expenses for that tax year and had also provided the funds to pay that tax. Yet, such tax year has not yet been audited. The Service does not have the cooperation of nor the records of the other members of the group. As such, it would be difficult for the Service to make a determination as to which party in fact made the overpayment. Furthermore, even if the Service could ascertain who in fact made the overpayment, there is a question as to whether another member of the group may be deemed to have made the overpayment, (irrespective of which member of the group provided the funds), on the basis that the remitting member paid the tax on behalf of this other member. Accordingly, the Service should not issue a refund to any member without having first interplead the other members in a refund action to be filed by the member seeking the refund.

IRC section 6402(j) provides an exception to the above general rule that the refund must be paid to the common parent of the group. IRC section 6402(j), which was originally codified as IRC section 6402(i) under the Technical and Miscellaneous Revenue Act of 1988, Public Law 100-647, section 6276, is with respect to refunds

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to certain fiduciaries of insolvent members of affiliated groups. IRC section 6402(j) states that:

“Notwithstanding any other provision of law, in the case of an insolvent corporation which is a member of an affiliated group of corporations filing a consolidated return for any taxable year and which is subject to a statutory or court-appointed fiduciary, the Secretary may by regulation provide that any refund for such taxable year may be paid on behalf of such insolvent corporation to such fiduciary to the extent that the Secretary determines that the refund is attributable to losses or credits of such insolvent corporation.”

The only Treasury regulation promulgated under the authority of IRC section 6402(j) is Treas. Reg. section 301.6402-7. Treas. Reg. section 301.6402-7, as promulgated under T.D. 8387, 1992-1 C.B. 306 and effective January 30, 1992, is with respect to “rules for the payment of refunds and tentative carryback adjustments to the fiduciary of an insolvent financial institution that was a subsidiary in a consolidated group.”

Sub 1 does not meet the exception under IRC section 6402(j), and the regulations promulgated thereunder, because although Sub 1 purportedly had incurred most of the income and expenses for the years at issue and had paid most of the taxes, Sub 1, the subsidiary in receivership, is not a financial institution. Since there are no regulations promulgated that allow the Service to issue refunds to an Industry Z subsidiary of a consolidated group, there is no authority to issue a refund to the receiver of Sub 1 of the consolidated group, without first breaking the common parent’s agency authority to act for Sub 1.

Refund for Year 4

The filing of a consolidated return with respect to Year 4, the year of a purported overpayment, will be an original return that can constitute a claim for refund. An original return, in order to constitute a claim for a refund, must request a refund for that particular year. Under Treas. Reg. section 301.6402-3(a)(5):

“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 whether such amount shall be refunded to the taxpayer or shall be applied as a credit against the taxpayer’s estimated income tax for the taxable year immediately succeeding the taxable year for which such return (or amended return) is filed.”

Since the Year 4 consolidated return filed by Sub 1 will be an original return and purportedly there are overpayments for Year 4, Sub 1 can file suit for a refund after

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the Service denies the taxpayer's claim for a refund, or, if the Service takes no action on the refund claim, after 6 months from the date the claim was filed.

In order to protect the Treasury from a situation where a refund might be issued to the wrong member, our recommended course of action where the Service has severed the common parent's agency authority is for:

1. Sub 1 to file the Year 4 consolidated return, including all of the group's income and expenses. The filing must comport with Treas. Reg. section 301.6402-3(a)(5), as quoted above, with respect to containing a statement setting forth the amount determined as an overpayment and advising whether such amount shall be refunded in order for the original filing to constitute a claim for a refund.
2. Once the original Year 4 consolidated return made on behalf of Sub 1 is filed, and assuming it contains a statement for a claim for a refund with respect to the overpayment, as mentioned above, the Service should disallow the claim.
3. In the event the receiver of Sub 1 files a refund action in the District Court or the Court of Federal Claims, then the Department of Justice should interplead all of the other members of the consolidated group. In this way, a court will determine to which member the Service will pay the refund without the Service having to risk paying a refund to the wrong member.

We suggest that if the receiver of Sub 1 seeks a refund for Year 4 the receiver file the Year 4 return with the appropriate statement setting forth the amount determined as an overpayment and advising whether such amount shall be refunded. Under the circumstances where the receiver seeks a refund with respect to the overpayment for Year 4, the original return can suffice for a claim for a refund. When the Service disallows the claim for a refund, it is at this point in which a refund action may be brought. From the receiver's perspective, the earlier a claim is disallowed, the earlier a refund action can be filed.

It is our understanding of the facts that there may be an overpayment for Year 4. The Service Center currently has placed a hold with respect to issuing a refund for the Year 4 overpayments. We urge that the Service Center continue holding the funds until the matter is finally resolved by a court and the government is discharged from any further liability regarding any refunds.

We have set forth further instructions below in the next section as to how to address the refunds for Year 1, Year 2 and Year 3.

Issue #3 Breaking agency with respect to Year 1, Year 2 and Year 3

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The District Director should break agency between Common Parent Corp. and Sub 1 with respect to the consolidated tax liability for Year 1, Year 2 and Year 3 in order to deal directly with Sub 1 instead of Common Parent Corp., as its agent.

To not break agency for the prior Year 1, Year 2 and Year 3 years would be inequitable given that for Year 4 and Year 5 (the loss year), the Service would be dealing directly with Sub 1 with regard to Sub 1's liability for the entire consolidated tax, while the Service would be dealing with the Common Parent Corp. for the earlier Year 1, Year 2 and Year 3 tax years. We also note that additional issues might be raised if the Service does not break agency for Year 1, Year 2 and Year 3 as to which member the Service should deal with under Treas. Reg. section 1.1502-77 for determining the amount of the net operating loss for Year 5 in light of the fact that taxpayer will be claiming a net operating loss carryback to Year 2 and Year 3.

Since Common Parent Corp. continues to be a disinterested party with respect to matters involving the tax liability of the consolidated group, it is unlikely that it will file a claim for a refund. Sub 1 is the only member attempting to comply with its obligations with respect to the tax liability of the consolidated group. If Common Parent Corp. fails to file the refund claim and if the Service does not break agency, Sub 1 would be unable to seek a refund for these years.

Therefore, the most practical method for dealing with the facts before us is to break agency between Common Parent Corp. and Sub 1 with respect to the consolidated tax liability for Year 1, Year 2 and Year 3. This will allow Sub 1 to file refund claims for any of those tax years.

Instructions Regarding the Year 1, Year 2 and Year 3

An original return filed with respect to either Year 5 or Year 4 does not constitute a claim for refund for the Year 2 and Year 3 NOL carryback years. The taxpayer must file a claim for refund for the carryback years if it wants refunds from those years based on a loss carryback from a later year. Our recommended course of action, where the Service has severed Common Parent Corp.'s agency authority for Year 1, Year 2 and Year 3, is:

1. For each year, Sub 1 should file an amended consolidated return (i.e., a refund claim) on its own behalf including all of the group's income and expenses with respect to each year.
2. Once the amended consolidated return for each of the respective years is filed on behalf of Sub 1, and assuming they constitute a valid refund claim for a refund as mentioned above, the Service should disallow the refund claim.
3. In the event the receiver files a refund action in District Court or the Court of Federal Claims, then the Department of Justice should interplead all of the

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members of the consolidated group. In this way, a court will determine to which member the Service should pay the refund without the Service risking the payment of a refund to the wrong member.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

At present, neither the Service (nor Sub 1) has a means to determine the accuracy of the consolidated taxable income or loss for the Common Parent Corp. group for Year 4 and Year 5 because Common Parent Corp. has not participated in filing a return with respect to Year 4 and Year 5. Although the attorneys for the receiver have indicated that Sub 1 purportedly had most, if not all, of the income and expense with respect to the consolidated group, we cannot verify the accuracy of the entire statements at this time. Without such knowledge, it is difficult to determine whether there is loss incurred for Year 5 that can be carried back to prior years.

We note that once the receiver for Sub 1 has filed a consolidated return on its own behalf, the statute of limitations for an assessment begins to run with respect to that subsidiary.

There is authority that where the receiver of Sub 1 files a return reporting tax, the return is filed for purposes of this subsidiary's obligation to file a tax return. See Germantown Trust Co., v. Commissioner, 309 U.S. 304 (1940). (Where a fiduciary that filed a fiduciary return rather than a corporate income tax return, the Supreme Court held that the fiduciary had filed a return for statute of limitations purposes).

Year 4 and Year 5 Returns

The Year 4 and Year 5 returns were prepared as consolidated returns for signature as "Common Parent Corp., % xxxxx, Receiver for Sub 1".

We note that the signature should not be as above, but rather as "% xxxxx, Receiver for Sub 1". The caption on the top of the Forms 1120 should state the name of group; "Common Parent Corp. and Subsidiaries".

Please call if you have any further questions.

Jasper L. Cummings, Jr.

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